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Supreme Court, U.S.
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No.

In The
Supreme Court of the United States

ANDREW D. GLOGOWER,
Petitioner,

v.

SHARON P. CLARK, LIQUIDATOR OF NATIONAL BUSINESS ASSOCIATION TRUST AND NATIONAL BENEFIT ADMINISTRATORS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Should this Court resolve a conflict among the circuits in interpreting and applying 11 U.S.C. § 523(a)(4) of the bankruptcy code, which provides that a debt for defalcation in a fiduciary capacity is not dischargeable, so that all circuits comply with this Court's determination in *Chapman v. Forsyth*, 2 U.S. 202 (1844) that a denial of discharge for such defalcations requires a finding that the debtor took money from a technical or express trust?

2. Did the unpublished decision of the Ninth Circuit Court of Appeals effectively permit Kentucky state insurance regulations to override established Federal bankruptcy law, in violation of the bankruptcy uniformity clause of the U.S. Constitution?

PARTIES TO THE PROCEEDINGS

Petitioner is Andrew D. Glogower, the debtor in United States Bankruptcy Court, District of Arizona, appellant/cross-appellee on appeal to the District Court, and appellee on appeal in the Ninth Circuit Court of Appeals.

Respondent is Sharon P. Clark, successor to Janie A. Miller and George Nichols III, the Commissioner of the Kentucky Department of Insurance, serving as Liquidator of National Business Association Trust and National Benefit Administrators (the "Liquidator"). The Liquidator was the plaintiff in an adversary action in Bankruptcy Court, appellee/cross-appellant on appeal to the District Court and appellant on appeal in the Ninth Circuit Court of Appeals.

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PETITION FOR A WRIT OF CERTIORARI

Andrew D. Glogower ("Glogower") respectfully petitions for a writ of certiorari to review the memorandum decision of the Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The decision of the Ninth Circuit Court of Appeals is not reported, but the unpublished memorandum disposition dated April 3, 2009 is available on Westlaw at 2009 WL 887959. The order denying the Petition for Rehearing and the Petition for Rehearing En Banc dated May 11, 2009, and the decisions of the district court and the bankruptcy court are not reported. Copies of all four decisions are reproduced in the Appendix. (App. A, App. B, App. C, and App. D).

STATEMENT OF JURISDICTION

The judgment of the U.S. Court of Appeals for the Ninth Circuit was entered on April 3, 2009. A timely petition for rehearing/rehearing en banc was filed on April 15, 2009. The petition for rehearing was denied on May 11, 2009. This petition is timely under Supreme Court Rule 13.1 because it is filed within 90 days of entry of the denial of rehearing. The jurisdiction of the United States Supreme Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED

The United States Bankruptcy Code, 11 U.S.C. § 727 provides, as to a debtor under Chapter 7, that,

except in circumstances enumerated in that section and except as to certain categories of debts excepted from discharge under 11 U.S.C. § 523(a), "[t]he court shall grant the debtor a discharge." (App. E). 11 U.S.C. § 523(a)(4) excepts from dischargeability any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." (*Id.*).

Article I, Section 8, Clause 4 of the U.S. Constitution provides for the power of Congress "To establish . . . . uniform Laws on the subject of Bankruptcies throughout the United States." (*Id.*).

STATEMENT OF THE CASE

It has been more than 75 years since this Court has visited the issue of non-dischargeability for defalcation in a fiduciary capacity under the U.S. Bankruptcy Code. In the interim, the Circuit Courts of Appeals have interpreted and applied 11 U.S.C. § 523(a)(4) and its predecessor, § 17(a)(4), in incompatible and contradictory fashion. The result is a hodge-podge of rulings, with no corresponding attempts to reconcile decisions among, between, and even within, the Circuits. This petition arises out of a Ninth Circuit Panel's refusal, in an unpublished decision, to apply even its own law.

This petition further arises out of the Ninth Circuit's insistence, perhaps reflecting the utter disarray of the published decisions, on elevating Kentucky state insurance law over Federal bankruptcy law. The Ninth Circuit, by inappropriately expanding the scope of non-dischargeability under 11 U.S.C. § 523(a)(4), not only failed to give proper effect to the discharge provision of 11 U.S.C. § 727, but violated the

federal preemption doctrine and the bankruptcy clause of the United States Constitution, Article I, Section 8, Clause 4.

A. Facts.

In the late 1980s, Glogower served as director of a company that administered types of "self insurance" or insurance alternative programs. One type of program administered by the company, referred to as a Multiple Employee Welfare Arrangement, involved a group of employers who made monthly contributions to a fund for the purpose of paying employee health care claims as they arise, instead of purchasing standard insurance.

National Business Association Trust ("NBAT") was created to provide health care benefits under certain identified health plans; National Benefit Administrators, Inc. ("NBA") was the administrator of NBAT. Glogower was an officer, director and shareholder of NBA.

In 1987, NBAT and NBA entered into an agreement whereby NBA was appointed plan supervisor to, *inter alia,* market and sell the plan and approve and administer claims. The agreement expressly provides that NBA is entitled to a fee of 20% of all contributions (the "20% Administrative Fee"). (App. F). The agreement further provides that NBA "shall not be liable for any failure or refusal by [NBA] to pay or honor any application for benefits" and that NBA is "expressly indemnified by [NBAT]" against any losses and shall incur no liability for any act or failure to act not connected with processing and payment of claims. (*Id.*).

As the District Court pointed out, "the 20% Administrative Fee was kept in an account separate from the 80% claims portion." (App. B, 21a). This is not a disputed fact in any of the opinions below. (See App. A, B, C).

In 1989, Glogower authorized a bonus payment from NBA to himself in the amount of $362,282.70 (the "Bonus Payment") and payments from NBA to himself to repay a promissory note for accrued but unpaid salary, in the total amount of $395,000.00 (the "Loan Payments"). The District Court pointed out that Glogower "received the Bonus Payment and the Loan Payments from the separate account holding the 20% Administrative Fee." (App. B, 21a). Again, this is not a disputed fact in any of the opinions below. (See App. A, B, C). During trial, the Liquidator's attorney admitted that the payments did not come from trust money:

> The Court: *** Are you going to put on evidence that he paid this money out of an express trust fund?
>
> Mr. Jordan: The checks did not come out of NBAT's account.

(App. J)[1].

---

[1] Continuing the colloquy, the Bankruptcy Court noted the difficulty this evidence posed for the Liquidator's case: "Well, isn't that going to be problematic for the defalcation of the fiduciary capacity? . . . Penick says you got show (sic) the – an express trust." (*Id.*).

B. Procedural Background.

1. The Kentucky State Court Orders.

The Franklin Circuit Court, Commonwealth of Kentucky (the "Kentucky State Court") entered orders (1) finding that NBAT was an unauthorized insurer doing business in Kentucky and insolvent, and ordering that NBAT be liquidated, (App. G); and (2) that NBA be liquidated (the "Kentucky Liquidation Order"). (App. H). The Kentucky State Court noted that the U.S. District Court for the Western District of Kentucky had previously determined that NBA as administrator for NBAT was "subject to regulation by state law" and that the District Court had "effectively determined that there was no distinction between NBA and NBAT for the ***application of Kentucky insurance laws***." (*Id.*, emphasis added). The Kentucky Court "determined that NBA and NBAT is a single identity" and ordered that NBA be placed into liquidation with NBAT. (*Id.*).

While establishing the single identity of NBA and NBAT, the Kentucky Liquidation Order does not address the legitimacy of the separate bank account maintained for contractual administrative fees. Nor does that Order purport to address or control future bankruptcy proceedings, including actions to determine non-dischargeability for defalcation in a fiduciary capacity under 11 U.S.C. § 523(a)(4). (*Id.*).

Contemporaneously, an investigation by the U.S. Department of Labor found no evidence of wrongdoing or commingling of funds: (1) "First, this does not appear to be the case where the subjects actively misled the trustees;" (2) "Second, while ultimately the

trust failed, it had a history of success;" (3) "The administrative fee charged by the administrators were likewise in conformity with industry standards;" and (4) "Finally, no evidence was developed of skimming or misappropriation of funds." (App. I). The Department of Labor accordingly declined to prosecute. (*Id.*)

2. The Bankruptcy Proceedings.

Glogower thereafter filed a Petition for relief under Chapter 7 of the Bankruptcy Code. The Liquidator's predecessor filed an adversary complaint alleging, *inter alia*, that Glogower's indebtedness for (1) the Loan Payments, (2) the Bonus Payment and (3) all unpaid NBAT claims was non-dischargeable under 11 U.S.C. § 523(a)(4), as having been incurred by defalcation in a fiduciary capacity.

During trial, the Bankruptcy Court noted that under *In re Penick*, 199 B.R. 16 (Bankr. E.D. Ky), *rev'd.* 149 F.3d 1184 (6th Cir. 1998) (unpublished), *cert. denied* 119 S.Ct. 619 (1999), one of the key elements in determining that a judgment is non-dischargeable "is that the money was taken from a trust fund." The Bankruptcy Judge quoted *Penick*'s statement of the second required element of non-dischargeability: "Relations create an express or implied trust that placed a specific risk (sic) in the hands of *Penick*," and enunciated his understanding of the key fact in this case: "Of the funds that came in, ***20 percent were to go to NBA*** to pay, in effect, their overhead and their operations. And so I would assume, at this point, that that's ***not a trust fund***, that portion of it." (App. K) (emphasis added).

Nevertheless, by Order dated July 9, 2004, the Bankruptcy Court ruled that the Bonus Payment and the Loan Payments, plus pre- and post-judgment interest thereon, were not dischargeable pursuant to 11U.S.C. § 523(a)(4). The Court ruled in favor of Glogower on the third category of claims, finding that Glogower's "apparent liability for all of the unpaid claims of NBAT" was dischargeable in bankruptcy. (App. C).

3. The District Court Appeal/Cross-appeal.

Both parties appealed the Bankruptcy Court decision, and the intermediate appeal was heard by the United States District Court, District of Arizona. By Order dated May 25, 2007, entered May 31, 2007, the District Court reversed the Bankruptcy Court's finding that the Bonus Payment and Loan Payments were not dischargeable under 11 U.S.C. § 523(a)(4) and affirmed the Bankruptcy Court's finding that Glogower's apparent liability for all of the unpaid claims of NBAT was dischargeable. (App. B).

Noting that 11 U.S.C. § 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity," the District Court pointed out that the Ninth Circuit's broad general definition of fiduciary – a relationship involving confidence, trust and good faith – is inapplicable in the dischargeability context. (*Id.*). The District Court noted both that the Ninth Circuit has adopted a narrow definition of "fiduciary" for purposes of § 523(a)(4) and that the rule adopted by the Sixth Circuit, which encompasses Kentucky, is the same as that in the Ninth Circuit. The term "fiduciary" under § 523(a)(4) applies only to "express or technical trusts." (*Id.*, citing *In re Cantrell*,

329 F.3d 1119, 1125 (9th Cir. 2003); *In re Brady*, 101 F.3d 1165, 1173 (6th Cir. 1996)).

4. The Ninth Circuit Appeal.

The Liquidator appealed to the Ninth Circuit the District Court's determination of dischargeability with respect to the Bonus Payment and the Loan Payments. The Liquidator's briefs focused not on 11 U.S.C. § 523(a)(4) or other bankruptcy law, but on the underlying insurance regulations, arguing that the District Court's finding of non-dischargeability under federal bankruptcy law created an "obvious loophole [that] further obstructs regulator's ongoing efforts to effectively regulate the insurance industry." Thus, the first of the two issues raised by the Liquidator on appeal was whether the District Court decision "failed to give full faith and credit to the final order of the Commonwealth of Kentucky, Franklin Circuit Court (***in a state insurance insolvency proceeding***)." An amicus curiae brief filed by the National Association of Insurance Commissioners ("NAIC") similarly argued that the Kentucky Liquidation Order is entitled to "deference" over the Bankruptcy Code. The mission of the NAIC, as stated in the amicus brief, is to "support and improve state regulation of insurance." Accordingly, the amicus brief addressed, exclusively, state insurance regulations, as evidenced by the headings: (1) "The Kentucky Court's Ruling has not been Given Due Deference;" (2) "The Nonadmitted Insurance Model Act is Undermined by the District Court's Ruling;" and (3) "State Regulation of Insolvency is Jeopardized by the Discharge of These Liabilities."

Proceedings before the Ninth Circuit suggest that the appellate panel accepted at face value the theory of the Liquidator and the NAIC: that, despite the Liquidator's having invoked the bankruptcy jurisdiction of the federal courts by initiating an adversary proceeding, and despite that its adversary complaint is couched entirely, and properly, in terms of the elements of dischargeability under 11 U.S.C. § 523, this is really a case of Kentucky insurance regulation. In the first minutes of oral argument the Honorable R. Tallman, suggesting that "we can sort of get right to the heart of it here," noted the factual finding by the Kentucky State Court that NBAT and NBA "were one in the same entity," and declared that he "read that as being the alter ego, pierce the veil, whatever you want to call it." Stating further that "on top of that we have the fact that Mr. Glogower did not bother to comply with any of the insurance regulations of the State of Kentucky," Judge Tallman framed the issue on appeal as whether the bankruptcy court must "give full faith and credit to that factual finding [in state court] as to the issue of being one in the same for purposes of assessing fiduciary obligations under ERISA." (App. L). Despite counsel's repeated attempts to apply federal law under 11U.S.C. § 523(a)(4), the Panel continued to press insurance regulation issues:

> Judge Tallman: Well, that in part is a breach of the fiduciary duty, is it not, the failure to properly underwrite the insurance risk so that you collect sufficient premiums from the employers to see to it that all of the anticipated claims will be paid? ***

> Ms. Sandweiss: That's not the standard though under § 523. That may or may not be a standard of breach of fiduciary duty, and it may have been a breach under the unauthorized insurance laws. But remember, this is not a Kentucky state law case.

(App. L).

On April 3, 2009, the Ninth Circuit Panel filed its Memorandum reversing the District Court's finding of dischargeability. The Panel, giving lip service to Ninth Circuit law, recited that, for liability to be imposed under 11U.S.C. § 523(a)(4), a fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing. (App. A, citing *In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996)). The Panel then proceeded to give conclusive effect to its interpretation of the Kentucky Liquidation Order. The Panel rejected Glogower's argument that because the Bonus Payment and Loan Payments were paid out of a separate administrative account they were not made in violation of a fiduciary duty of the sort required by § 523(a)(4) and applicable cases; as grounds for its finding, the Panel noted that the Kentucky Liquidation Order had determined that NBAT and NBA were one entity and "we owe full faith and credit to this factual determination." The Panel found that the Loan Payments and Bonus Payment constituted defalcation under 11U.S.C. § 523(a)(4), because Glogower had paid himself "when he was fully aware that the entities (NBAT/NBA) he controlled could not pay the claims due the plan beneficiaries."

On May 21, 2009, the Liquidator filed a request that the Memorandum be re-designated as an opinion and published. (App. M). The Liquidator noted that the Memorandum had "***made a number of critical holdings pertinent to states' power to regulate insolvency and liquidation and the 11U.S.C. § 523(a)(4) dischargeability of debts incurred by an Employment Retirement Incomes Security Act ('ERISA') fiduciary.***" (*Id.*, emphasis in original). The Liquidator argued that there is a paucity of available case law on this issue, particularly "as it relates to ***unauthorized insurance trusts***." (*Id.*, emphasis added).

The Liquidator emphasized that the rule "does more than simply resolve a long-standing dischargeability case," putting forth as evidence the NAIC's amicus brief, and arguing that "the outcome of this case will impact ***the state-based*** system of insurer insolvency regulation – with particular relevance to the accountability of insurance trust fiduciaries to their policyholders." (*Id.* emphasis added).

The Liquidator argued that the Federal bankruptcy code requirements were merely a "glaring loophole" in state insurance regulation and that the bankruptcy code "loophole" could obstruct efforts "to effectively regulate the insurance industry." (*Id.*). The Liquidator chided even the bankruptcy court for "want[ing] to hear testimony on whether" the administrative fee paid to Glogower "constituted trust fund money" [which is precisely the requirement under 11U.S.C. § 523(a)(4)]. The Liquidator complimented the Ninth Circuit Panel for seeing through this purported ploy in applying bankruptcy law, and for instead deferring to

the Kentucky State Court on this issue that "is of critical importance to the effective regulation of the insurance industry." (*Id.*). The Liquidator further explained that the Ninth Circuit Panel's "explicit provision of full faith and credit to the Kentucky state court's ruling on the structure of the insurance trust and administrator in question is critical to the effective control of unauthorized insurance." (*Id.*). Finally, the Liquidator argued that "to further pervasive public interest in the effective regulation of the insurance industry," this case should be published. (*Id.*).

Glogower notified the Ninth Circuit that it disagreed with the Liquidator's analysis but had no objection to publication. On May 26, 2009, the request for publication was denied. (App. N).

C. Basis for Federal Court Jurisdiction in the First Instance.

This is a review of a Judgment of a United States Court of Appeals. That Judgment followed an appeal from a final Judgment of the United States District Court for the District of Arizona. The District Court Judgment arose out of an appeal and a cross-appeal from a final Judgment of the United States Bankruptcy Court for the District of Arizona, and was an appeal of right to the District Court, following a timely statement of election, pursuant to Bankruptcy Rule 8001(a). Therefore, the federal court properly had jurisdiction in the first instance.

REASONS FOR GRANTING THE PETITION

This Court has not addressed the proper interpretation of "defalcation in a fiduciary capacity"

under the Bankruptcy Code since 1934, long before implementation of the current version of 11 U.S.C. § 523(a)(4). The void in Supreme Court law has produced widely divergent and contradictory results among the Circuits, and it is necessary and appropriate that the conflicts be resolved.

This Court first set the standard in 1844, providing that defalcation in a fiduciary capacity under the Bankruptcy Code requires the existence of an express or technical trust. *Chapman v. Forsyth*, 2 U.S. 202, 207 (1844). Later, this Court made clear that the technical trust must exist prior to the act creating the debt and without reference to that act. See *Upshur v. Briscoe*, 138 U.S. 365, 378 (1890). The last time this Court revisited defalcation in a fiduciary capacity under the Bankruptcy Code, it reiterated that the debtor "must have been a trustee before the wrong and without reference thereto." *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934). But since 1934, this Court has been silent on the issue.

The Ninth and Sixth Circuits hold unequivocally that, for purposes of dischargeability under 11 U.S.C. § 523(a)(4), a finding of defalcation requires the misappropriation or failure to properly account for funds that constitute a specific trust "res." *In re Cantrell*, 329 F.3d 1119, 1126 (2002); *In re Garver*, 116 F.3d 176, 178 (6th Cir. 1997). The Ninth and Sixth Circuits are joined by the Tenth, and to a slightly lesser extent the Eleventh and Eighth Circuits, in holding that a trust res must exist before there can be a finding of defalcation under 11 U.S.C. § 523(a)(4). *In re Young*, 91 F.3d 1367, 1371-1372 (10th Cir. 1996); *In re Fernandez-Rocha*, 451 F.3d 813, 819 (11th Cir. 2006); *Hunter v. Philpott*, 373 F.3d 873, 874 (8th Cir.

2004). These circuits follow this Court's early decision in *Chapman,* 2 U.S. at 207. But there is a split among the remaining Circuits as to the requirements under 11 U.S.C. § 523(a)(4), with some Circuits holding that a fiduciary such as a lawyer, a majority stockholder, or even a country's ambassador, are automatically fiduciaries for all purposes and thus subject to nondischargeability as a fiduciary under the Bankruptcy Code. See *Marchiando v. State of Illinois*, 13 F.3d 1111 (7th Cir. 1994). Even within a single Circuit, a debtor may be entitled to a discharge under one panel's interpretation, but not under another. See *Hunter,* 373 F.3d at 874; *cf In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997). The results are so at odds as to be utterly irreconcilable.

As this Petition demonstrates, the Circuit Courts are perplexed as to the proper interpretation of 11 U.S.C. § 523(a)(4), clashing both in the standards they have articulated and in the results they have reached. As this Petition further demonstrates, the gross conflicts lead to the anomalous result in this case – that is, the Ninth Circuit, in its published opinions, clearly requires the finding of an express trust *res*, imposed before the act creating the debt and without reference to wrongdoing, but in this unpublished decision, the Ninth Circuit Panel deemed itself free to adopt the broad definitions of fiduciary described in other Circuits. Mr. Glogower could not possibly have known, at the time he received the payments out of the 20% Administrative Fee, whether the Ninth Circuit would enforce its own interpretation of 11 U.S.C. § 523(a)(4), the Fifth Circuit's broad interpretation, or even the Eighth Circuit's conflicted interpretation, each of which produces a different result on the same set of facts. The results in the various Circuits are

irreconcilable. Because the Constitution requires uniformity among bankruptcy laws throughout the nation, the conflicts must be resolved by this Court, and this Court should granted certiorari in order to resolve this split. *AT & T Corp. v. Hulteen*, 129 S.Ct. 1962, 1968 (U.S., 2009)

Granting of the Petition is further appropriate for the independent reason that the Ninth Circuit Panel has effectively permitted Kentucky state insurance law to overrule the discharge and fresh start provisions of the United States Bankruptcy Code, in violation of the Bankruptcy Clause, U.S. Const., Art. 1, § 8, Cl.4 and basic principles of federal preemption. The Ninth Circuit has disregarded established federal law, and imposed upon Glogower a punitive result justifiable only by reference to state law policies. Review by this Court is necessary and appropriate lest the principles and legal protections embodied in the Bankruptcy Code be further eroded to suit the demands of state regulators.

The full impact of the Memorandum, and its potential for misuse, become fully apparent upon review of the transcript of oral argument and the Liquidator's request for publication. The Liquidator's agenda could not be more apparent: the thrust of the case, and the appeal in particular, is to promote and extend an agenda of closing bankruptcy-related "loopholes" to further the interests of state insurance regulators, and the Memorandum, intentionally or not, fosters that agenda at the expense of the rules and policies of federal bankruptcy law.

This case is not about state insurance insolvency law; it is a bankruptcy case, to be considered and

determined under the Bankruptcy Code, in general, and 11 U.S.C. § 523(a)(4), in particular. The drafters of the Bankruptcy Code, weighing the interests of creditors against the policy considerations favoring a "fresh start" for Chapter 7 debtors, carefully enumerated and defined those limited categories of debts that are excepted from discharge. The question on appeal thus was not whether the Kentucky State Court properly determined that Glogower was liable for certain debts under Kentucky state law, but whether Glogower was entitled to discharge of those debts under Federal bankruptcy law. By departing from this framework of analysis, the Ninth Circuit not only violated fundamental principles of federal preemption but failed to give effect to Article 1, Section 8, Clause 4 of the Constitution regarding the enactment of uniform bankruptcy laws. This Court should, accordingly, grant certiorari to address the Ninth Circuit's dual violations of the Bankruptcy Clause.

I. THE CIRCUITS ARE IRRECONCILABLY SPLIT ON THE PROPER INTERPRETATION OF DEFALCATION IN A FIDUCIARY CAPACITY UNDER 11 U.S.C. § 523(A)(4); IT IS APPROPRIATE, AFTER 75 YEARS OF SILENCE, THAT THIS COURT WEIGH IN AND RESOLVE THE CONFLICT.

A. Non-Dischargeability of Debts in Bankruptcy.

It is one thing for a creditor to have a valid claim. It is quite another for the claim to be determined non-dischargeable. The filing of a petition in bankruptcy triggers an automatic stay of actions against the debtor, the creation of an estate, and the appointment

of a trustee. See 11 U.S.C. §§ 362, 541 and 701. The estate comprises the property that will be available to satisfy the costs of bankruptcy administration and pay allowed claims of creditors, subject to the right of the debtor to declare some of the estate exempt under 11 U.S.C. § 522(b). See 11 U.S.C. § 541; *Segal v. Rochelle*, 382 U.S. 375 (1966) (What constitutes "property" in a bankruptcy estate must be determined by the Bankruptcy Code). To the extent that a creditor may have a right to payment, the Bankruptcy Court has exclusive authority to determine the amount and allowance of such creditor's claims. *Brown v. Gerdes*, 321 U.S. 178 (1944).

The bankruptcy court is required to grant a Chapter 7 debtor a discharge, affecting pre-petition debts generally, subject to enumerated exceptions, mostly involving improper conduct, set forth in 11 U.S.C. § 727(a). In keeping with the "fresh start" purposes behind the Bankruptcy Code, a central purpose of the Code is to permit certain insolvent debtors to "enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.' [citation omitted]" *Grogan v. Garner*, 498 U.S. 279, 286 (1991).

11 U.S.C. § 523 provides, as an exception to § 727, that certain specific debts (or categories of debts) are not affected by the debtor's discharge. These non-dischargeable debts include certain taxes, spousal maintenance, child support and certain debts found to have been incurred under specific circumstances of wrongdoing. The sole subsection of 11 U.S.C. § 523(a) at issue in this case is subsection (4), declaring non-dischargeable debts for "fraud or defalcation while

acting in a fiduciary capacity, embezzlement or larceny."

B. 11 U.S.C. § 523(a)(4): as Interpreted by This Court.

The concept of denial of discharge for defalcation in a fiduciary capacity goes back to the Bankruptcy Act of 1841. Three years later, this Court considered whether a factor who sold property belonging to his principal, and failed to pay the principal the proceeds, owed him a debt created in a fiduciary capacity. The Court held that a factor was not a fiduciary and made clear that under the Bankruptcy Act, the concept of fiduciary should be narrowly defined:

> In almost all the commercial transactions of the country, confidence is reposed in the punctuality and integrity of the debtor, and a violation of these is, in a commercial sense, a disregard of a trust. But this is not the relation spoken of in the (Bankruptcy Act). . . . *The act speaks of technical trusts,* and not those which the law implies from the contract.

Chapman v. Forsyth, 2 U.S. 202, 207 (1844) (emphasis added).

Subsequently, this Court refined and narrowed the concept of fiduciary articulated in *Chapman,* making clear that the technical trust must exist prior to the act creating the debt and without reference to that act. See *Upshur v. Briscoe*, 138 U.S. 365, 378 (1890). As the Court stated in *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934) (emphasis added):

> It is not enough that by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee ex maleficio. *He must have been a trustee before the wrong and without reference thereto.* In the words of Blatchford, J., "The language would seem to apply only to a debt created by a person who was already a fiduciary when the debt was created."

(Quoting *Upshur v. Briscoe*, supra.)

This court's restrictive reading of the phrase "fiduciary capacity" is fully consistent with the "fresh start" policy of federal bankruptcy law, *Lines v. Frederick*, 400 U.S. 18, 19 (1970), and the well-established principle in this Court that exceptions to discharge should be limited to those clearly expressed in the statute. *Gleason v. Thaw,* 236 U.S. 558, 562 (1915).

C. There is An Irreconcilable Split in Circuits and Non-Compliance With *Chapman.*

The circuits are split regarding the precise nature of the fiduciary relationship required to prove defalcation under § 523(a)(4). While there is unanimous agreement that defalcation requires: 1) a fiduciary relationship; 2) a breach of that fiduciary relationship; and 3) a resulting loss. *In re Garver*, 116 F.3d 176, 178 (6th Cir. 1997), about half the circuits, including the Ninth (whose orders are at issue here) and the Sixth (site of Kentucky, where the underlying case originated) require a further showing of an express or technical trust, rather than a mere showing of a fiduciary relationship, and a specific trust res

involved in the defalcation. This narrow interpretation of a fiduciary under § 523 (a)(4) would omit or not necessarily include situations where the individual was acting in a fiduciary capacity under law outside of bankruptcy.

The Sixth, Ninth, and Tenth Circuits have clearly adopted the narrow view of § 523(a)(4), requiring an analysis beyond mere existence of a fiduciary relationship. The Sixth Circuit, in *Garver*, found that an attorney-client relationship, although requiring the attorney to act in a fiduciary capacity, is not necessarily a fiduciary relationship under § 523(a)(4), 116 F.3d at 179 (attorney must hold funds in trust to satisfy the fiduciary element). In addressing whether the debt is the result of defalcation, the court rejected the broad definition – "failure to meet an obligation while acting in a fiduciary capacity" – and held that there must be an express or technical trust. *Id.*

Another Sixth Circuit case, *In re Penick*, cited at length in these Bankruptcy Court proceedings, follows the same logic, holding that "the mere recognition that an insolvent corporation or one of its directors owes a fiduciary obligation to the corporation's creditors does not create an actual trust fund as required by § 523(a)(4)." *Penick*, 149 F.3d at 4.

The Ninth Circuit, in its published opinions, has taken a similarly narrow view. See *In re Cantrell*, 329 F.3d 1119, 1126 (2002)(while officers and directors act in a fiduciary capacity, they are not trustees of corporate assets for purposes of non-dischargeability under 11U.S.C. § 523(a)(4)).

The Tenth Circuit holds that, as to a finding of nondischargeability under § 523(a)(4), "[t]he court must find that the money or property on which the debt at issue was based was entrusted to the debtor....an express or technical trust must be present," *In re Young*, 91 F.3d 1367, 1371-1372 (10th Cir. 1996)(despite the general fiduciary duty an attorney owes to a client, no fiduciary relationship existed for the purposes of § 523(a)(4), where an attorney and contractor exchanged services and the attorney failed to make an accounting to the contractor of the amount owed).

Other circuits appear to lean toward a narrow interpretation. The Eleventh Circuit held that a doctor's debt on a judgment relating to his failure to comply with a state statute requiring him to maintain malpractice insurance, an escrow account, or a letter of credit, did not fall under § 523(a)(4), because the statute did not entrust funds in the doctor. *In re Fernandez-Rocha*, 451 F.3d 813, 819 (11th Cir. 2006). The court discussed the inapplicability of "constructive" or "resulting" trusts to § 523(a)(4), "because the act which created the debt simultaneously created the trust relationship." *Id.* at 816.

The Eighth Circuit appears to adopt the narrow interpretation but is hopelessly inconsistent. The Bankruptcy Appellate Panel in that Circuit has held that the fiduciary relationship under § 523(a)(4) must be one arising from an express or technical trust, stating that a broad definition of confidence, trust and good faith does not apply. *In re Shahrokhi*, 266 B.R. 702, 707-708 (8th Cir. BAP 2001). One Panel of the Eighth Circuit held that "prior holdings of our court

and the United States Supreme Court require that we look specifically at the property that is alleged to have been defalcated to determine whether [the debtor] was legally obligated to hold that specific property for the benefit of the Funds. *Hunter v. Philpott*, 373 F.3d 873, 874 (8th Cir. 2004) (Judges Wollman, Arnold and Colloton).

But, just seven years earlier, a different Eighth Circuit Panel (Judges McMillian, Gibson and Magill) took a broader interpretation of 11 U.S.C. § 523(a)(4). The Court found that a judgment debt against an attorney who breached his duty by failing to disclose a conflict of interest and by usurping his clients' expected 20% interest in real estate, which he kept for himself, fell under § 523(a)(4), despite the absence of an identifiable trust res. *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997).

The Seventh, Fifth, and Second Circuits adopt a broad view of the fiduciary relationship required to fall under the non-dischargeability provision of § 523(a)(4). The Seventh Circuit focuses on the fiduciary relationship rather than the requirement of a trust or a debt that involves those funds. *Marchiando v. State of Illinois*, 13 F.3d 1111 (7th Cir. 1994). The *Marchiando* Court held that the applicable relationship is one where "one party to the relation is incapable of monitoring the other's performance of his undertaking, and therefore the law does not treat the relation as a relation at arm's length between equals," giving as examples lawyer-client, director-shareholder, and managing partner-limited partner. *Id.* at 1116. Although citing cases that say constructive, resulting, and implied trusts do not qualify for § 523(a)(4), the Court stated that the key to dischargeability is to find

a "trust or other fiduciary relation that has an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed." *Id.* at 1115. A lawyer's fiduciary duty to his client, or a director's duty to his corporation pre-exists any breach of duty." *Id.*

The Fifth Circuit also follows this broad view, holding that § 523(a)(4) applies to a debt where a majority stockholder in a corporation made profit sharing contributions for his own benefit to the exclusion of the minority shareholder. *In re Davis*, 3 F.3d 113, 116 (5th Cir. 1993). The conclusion of non-dischargeability was based only on the breach of fiduciary relationship of the majority stockholder to the minority shareholder; no finding of a trust is mentioned.

The Second Circuit also adopts a broad view, citing *Marchiando* for its proposition that a debtor with a difference in knowledge or power over the principal fulfils the requirements of § 523(a)(4). *In re Hayes*, 183 F.3d 162, 167 (2nd Cir. 1999). The Court further stated, "it has been clear...that the defalcation exception is not limited to express trusts, i.e., situations where a trustee is a beneficial owner of a res held and managed for a named beneficiary." *Id.* A result of this interpretation is that the attorney-client relationship, although usually not involving a technical or express trust, is considered a fiduciary relationship within the meaning of the defalcation exception. *Id.* at 168. Further, the Court cites decisions regarding fiduciary status of directors, controlling stockholders, and corporate officers, notwithstanding the absence of an express trust. *Id.*

These decisions support the Court's holding that a debt was not dischargeable under § 523(a)(4), because an attorney owed a fiduciary responsibility to an estate. *Id.* The debt was for a judgment against an attorney based on excessive legal fees, which was a breach of this general fiduciary responsibility. *Id.*

The Fourth Circuit similarly held that an ambassador's debt resulting from him spending embassy funds to prepare a case for his own asylum was not dischargeable under § 523(a)(4). *In re Uwimana*, 274 F.3d 806, 812 (4th Cir. 2001). This holding was based on an assertion that "ambassadors are, by definition, fiduciaries for the country they represent." *Id.* at 811. The fiduciary relationship was based on entrustment with state secrets and financial assets and an expectation of undivided loyalty and faithful service. *Id.* at 811. That Circuit found a breach of duty based on a breach of loyalty, because "an agent must avoid conflicts of interests with his or her principal." *Id.* at 812.

It is unclear whether the remaining circuits follow the narrow or broad view. The D.C. Circuit and the First Circuit have not addressed the issue. The Third Circuit seems to take a broad interpretation of § 523(a)(4), finding that a director and shareholder owed a fiduciary duty to creditors, and thus his debt related to diversion of progress payments was not dischargeable. *In re Docteroff*, 133 F.3d 210, 217 (3rd Cir. 1997). However, in a case just six years earlier, the Third Circuit mentioned the narrow standard and its use by lower district courts within the Circuit, concluding that the distinction was not applicable to its case. *In re Goldberg*, 932 F.2d 273, 278 (3rd Cir. 1991).

The Ninth Circuit Panel of course, in its review of this case, follows the broad view, seeming to reverse precedent. (App. A). The Panel found that the Loan Payments and Bonus Payment are non-dischargeable under § 523, even though the record was clear that the payments were not made out of a trust res.

While there are other relevant cases, the cases above present the various approaches utilized by the circuits and demonstrate adequately the confusion.

Adding further to the inconsistencies and hopeless confusion among the Circuits is that in 1978 the language of the subject Code Section changed, and this Court has not set forth a post-1978 interpretation of defalcation in a fiduciary capacity. Indeed, this Court has not addressed defalcation in a fiduciary capacity under the Bankruptcy Code in more than 75 years. See *Davis,* 293 U.S. 328. Section 17(4) of the former Bankruptcy Act excepted from discharge debts for "misappropriation or defalcation ***while acting as an officer*** or in ***any*** fiduciary capacity." (emphasis added) The current section removes the reference to "officer" and further narrows the statute by removing the word "any." The change appears to narrow the possible interpretation of a fiduciary relationship.

The U.S. Constitution requires that bankruptcy laws must be uniform throughout the United States. *Railway Labor Executives' Ass'n v. Gibbons,* 455 U.S. 457, 468 (1982); U.S. Constitution, Art. 1, § 8, cl. 4. The divergences among decisions interpreting the current version of 11U.S.C. § 523(a)(4) are such as to require this Court to intervene and resolve the conflict among the Circuits, and to provided uniformity as required by Art. 1, § 8, Cl. 4 of the Constitution.

D. The Result in This Case is Markedly Different Depending Upon the Circuit, or even the Specific Panel in Each Circuit.

The question whether Glogower committed defalcation in a fiduciary capacity under 11 U.S.C. § 523(a)(4) evokes different answers in different circuits, and sometimes different answers in the same circuit, depending upon the panel.

In the Sixth and Tenth Circuits, Glogower would be entitled to a discharge, because those Circuits require an express or technical trust, and the Bonus Payment and Loan Payments were paid out of separate funds, not trust funds. *In re Young*, 91 F.3d 1367, 1371-1372; *Penick*, 149 F.3d at 4.

Under published Ninth Circuit law, Glogower would be entitled to a discharge, because the term "fiduciary" under § 523(a)(4) applies only to "express or technical trusts," and Glogower had no fiduciary obligation with respect to the 20% Administrative Fee out of which he paid himself. *In re Cantrell*, 329 F.3d at 1125. But under unpublished Ninth Circuit law, Glogower was denied a discharge and an entirely new obligation was imposed on the debtor, solely for purposes of this case: even though the trust funds were kept separate from the non-trust funds, Glogower paid himself "when he was fully aware that the entities (NBAT/NBA) he controlled could not pay the claims due the plan beneficiaries." (App. A).

In the Eleventh Circuit, the anticipated result is slightly less clear but, because the Court refers to the inapplicability of "constructive" or "resulting" trusts in a § 523(a)(4) non-dischargeability action, and because

any obligation in this case would necessarily involve a constructive or resulting trust rather than an express trust, it appears that Glogower would receive his discharge. *In re Fernandez-Rocha*, 451 F.3d at 819.

In the Eighth Circuit, the result would depend upon which Panel reviewed the Glogower case. The *Hunter* panel found that ERISA funds themselves are not necessarily trust funds and could reasonably be expected to rule that, because Glogower was not legally obligated to hold the 20% Administrative Fee for the benefit of the claimants under the 80% Claims Portion, he had no fiduciary obligation under § 523(a)(4). But Glogower might expect a different result in front of the *Cochrane* panel, 124 F.3d at 984, which might, based upon *Cochrane*, find that the administrator-claimant relationship is the type of fiduciary relationship in which a breach gives rise to non-dischargeability under § 523(a)(4).

In the Seventh Circuit, the key inquiry might be whether the claimants were capable of "monitoring [Glogower's] performance of his undertaking," or it might be whether a "trust or other fiduciary relation existe[d] independent of [Glogower's purported wrong." The result is unclear under this standard. *Marchiando*, 13 F.3d 1111.

Because the Second and Fifth Circuits have no trust requirement, Glogower would presumably be denied a discharge under § 523(a)(4). *Davis*, 3 F.3d at 116; *Hayes*, 183 F.3d at 167. The result in the D.C., First and Third Circuits is unclear based upon present law in those Circuits.

Under this Court's interpretation of 11 U.S.C. § 523(a)(4), there was no defalcation in a fiduciary capacity, because the funds paid to Glogower were not part of a technical trust, existing prior to the act creating the debt and without reference to that act. *Chapman,* 2 U.S. at 207; *Upshur,* 138 U.S. at 378; *Davis,* 293 U.S. at 333.

II. THE NINTH CIRCUIT'S MEMORANDUM PERMITS KENTUCKY STATE LAW TO OVERRIDE ESTABLISHED FEDERAL BANKRUPTCY LAW IN VIOLATION OF THE BANKRUPTCY CLAUSE OF THE U.S. CONSTITUTION

Congress has the exclusive power "[t]o establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Constitution, Art. 1, § 8, cl. 4 (the "Bankruptcy Clause"). Unlike, for example, the Commerce Clause, the Bankruptcy Clause itself contains an affirmative limitation or restriction upon Congress's power: bankruptcy laws must be uniform throughout the United States. *Railway Labor Executives' Ass'n v. Gibbons,* 455 U.S. 457, 468 (1982); see *Secretary of Agriculture v. Central Roig Refining Co.*, 338 U.S. 604, 616 (1950) (distinguishing the Commerce Clause from Art. I, § 8, cl. 4). Indeed, Bankruptcy is one of only two federal legislative powers enumerated in Article I, Section 8 of the Constitution as to which the power to make "uniform" laws is made explicit. See *Pacific Gas and Elec. Co. v. California ex rel. California Dept of Toxic,* 350 F.3d 932, 943 (9th Cir. 2003).

The Ninth Circuit's analysis is contrary to basic principles of federal primacy and uniformity, and its determination of non-dischargeability should be set aside.

A. The Ninth Circuit Memorandum Exalts Kentucky State Insurance Regulations Over Federal Bankruptcy Law, Thus Violating the Federal Preemption Doctrine.

The Liquidator recognizes and expressly acknowledges that the Memorandum Decision in her favor is a triumph of "***the state-based*** system of insurer insolvency regulation" over the purported "loopholes" of federal bankruptcy law. (App. M). But any such triumph is inconsistent with the federal preemption doctrine and cannot stand unchallenged.

The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount. U.S. Const. Art. I, § 8, cl. 4; *International Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929). Congress exercised this power by enacting national, uniform bankruptcy laws, including the Bankruptcy Code, which necessarily exclude or displace any conflicting state regulation. *International Shoe*, 278 U.S. at 265. Accordingly, states may not pass or enforce laws to interfere with or complement the Bankruptcy Code or to provide additional or auxiliary regulations. *Id.* at 266. See also, *In re Wisconsin Builders Supply Co.*, 239 F.2d 649 (7th Cir. 1956), *cert. denied*, *Prentice v. Moskowitz*, 353 U.S. 985 (1957).

The Ninth Circuit Panel, reciting that the Kentucky State Court had found that NBAT and NBA

"were one entity," determined that it owed "full faith and credit" to that finding. The Panel's use of "full faith and credit" terminology evidences a profound miscomprehension of the interplay between state and federal law in bankruptcy case, which misconception led the Panel into error.

In a bankruptcy context, typical principles of *res judicata* and full faith and credit give way to the primacy of federal law. *Kalb v. Feuerstein*, 308 U.S. 433, 438-439 (1940) (States cannot, in the exercise of control over local laws and practice, vest state courts with power to violate the supreme law of the land.) Thus, while it is generally true that a judgment by a court of competent jurisdiction bears a presumption of regularity and is not thereafter subject to collateral attack, *Chicot County Drainage District v. The Baxter State Bank,* 308 U.S. 371 (1940), a different rule applies where a state judgment conflicts with federal bankruptcy law:

> Congress, because its power over the subject of bankruptcy is plenary, may by specific bankruptcy legislation . . . render judicial acts taken with respect to the person or property of a debtor whom the bankruptcy law protects nullities and vulnerable collaterally.

Kalb, 308 U.S. at 438-439.

The issue of non-dischargeability is to be determined by the bankruptcy court, with reference to federal law. See *Brown v. Felsen*, 442 U.S. 127 (1979),

interpreting § 17a(2) and (4) of the Bankruptcy Act.[2] Traditionally, the bankruptcy court determined whether the debtor was entitled to a discharge under § 14 of the Bankruptcy Act, but left the dischargeability of a particular debt under § 17 (now § 523) of the Act to be determined, after bankruptcy, by the court in which the creditor sued to enforce his prior judgment. In 1970, however, Congress altered § 17 to require creditors to apply to the bankruptcy court for adjudication of certain dischargeability questions, including those arising under §§ 17a(2) and 17a(4) (now §§ 523(a)(2) and (4)). 442 U.S. at 129-130.

The Senate Report accompanying the 1970 amendment described the bankruptcy court's jurisdiction over § 17 claims as "exclusive." S.Rep.No. 91-1173, p. 2 (1970). This Court noted in *Brown v. Felsen* that, while Congress did not expressly confront the problem created by pre-bankruptcy state-court adjudications,

> it would be inconsistent with the philosophy of the 1970 amendments to adopt a policy of res judicata which takes these § 17 questions away from bankruptcy courts and forces them back into state courts.

442 U.S. at 136. This Court noted further a statement by Professor Lawrence King, prepared for the National

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[2] Section 17 (2) omitted from discharge "liabilities for obtaining money or property by false pretenses or false representations . . . or for willful and malicious conversion of the property of another" and, under § 17a(4), debts that "were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."

Bankruptcy Conference, included in both the House and Senate Reports and placed in the Congressional Record by Representative Wiggins:

> [I]f the bill is passed, a single court, to wit, the bankruptcy court, will be able to pass upon the question of dischargeability of a particular claim and it will be able to develop an expertise in resolving the problem in particular cases.

S.Rep.No. 91-1173, p. 9 (1970); H.R.Rep.No. 91-1502, p. 8 (1970).

Whether Glogower should be denied a discharge under 11U.S.C. § 523(a)(4) of the Bankruptcy Code is strictly a federal question. The entire field of bankruptcy, and specifically questions of discharge, is preempted by federal law. By deferring to the Kentucky Liquidation Order, the Ninth Circuit has improperly elevated Kentucky state insurance regulations over federal bankruptcy law.

The Ninth Circuit's reliance on the Kentucky Court's ruling becomes more problematic when one recognizes that the issue whether Glogower's conduct satisfied the standards for non-dischargeability under § 523(a)(4) was not, and could not have been, presented to the Kentucky Court. The issues in the Kentucky proceeding, as, indeed, the Liquidator made clear in her request for publication, had to do with the standards and procedures applicable to the liquidation of insolvent insurers under state law. (App. M). The issues presented by the Liquidator's bankruptcy adversary claim, in contrast, involve, specifically and exclusively, whether the Liquidator's claim is rendered non-dischargeable by virtue of acts within the

parameters of § 523(a)(4), i.e., whether the underlying debt was "for fraud or defalcation while acting in a fiduciary capacity."

The Kentucky Liquidation Order, considered objectively, does not purport to control the issues in this case. (App. H) There is no reference to regulation by or under bankruptcy laws, and no holding that the "one entity" finding would apply under 11 U.S.C. § 523(a)(4) or any other bankruptcy law. More to the point, nothing in the Liquidation Order addresses the core issue in this case – whether an express trust relationship existed as to the 20% Administrative Fee.[3]

Lest there be any doubt, the Kentucky Court of Appeals has made clear that the Kentucky Insurance Code is a distinct statutory framework, which cannot be interpreted with reference to any other laws. *Albany Ins. Co. v. Stephens*, 926 S.W.2d 460, 462 (Ky.App. 1995) ("[T]hat other jurisdictions may have reached disparate conclusions founded in their peculiar statutory structures has little impact upon our interpretation of the distinct principles codified in the Kentucky Insurance Code.").

The policies and fundamentals of the Bankruptcy Code in any event override any state law and any

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[3] The evidence, in any event, shows unequivocally that the 20% Administrative Fee and the remaining 80% of the NBAT revenues were accounted for and treated differently. There is simply no basis for the Ninth Circuit's extreme, and illogical, leap to the conclusion that, because NBA and NBAT were (or became) one entity under state insurance regulations, 100% of the assets of the combined entity were subject to an express trust under federal bankruptcy law.

underlying state court determination of liability in the first instance. The Ninth Circuit's explicit deference to findings of the Kentucky State Court cannot withstand challenge in light of the Bankruptcy Clause and the findings of the Memorandum Decision should therefore be set aside on grounds of federal preemption.

B. The Memorandum Violates This Court's Prohibition Against a Bankruptcy Rule That Applies Only to One Debtor.

The Ninth Circuit Memorandum fails the uniformity requirement in Art. I, § 8, cl. 4 for another reason. This Court holds that the Bankruptcy Clause prohibits Congress from enacting a bankruptcy law that, by definition, applies only to one debtor. *Railway Labor*, 455 U.S. at 473. To survive scrutiny under the Bankruptcy Clause, "a law must at least apply uniformly to a defined class of debtors." Moreover, a bankruptcy law that is "confined . . . to the affairs of one named debtor can hardly be considered uniform. To hold otherwise would allow Congress to repeal the uniformity requirement from Art. I, § 8, cl. 4, of the Constitution." *Id.* This Court thus held that a law enacted during and in response to the bankruptcy proceedings of one regional railroad, and that would be applied to and affect only that railroad, was repugnant to Art. I, § 8, Cl. 4, of the Constitution. 455 U.S. at 458.

The Ninth Circuit Panel relied on Glogower's purported knowledge that the 80% Claims Portion was insufficient to pay claims as a basis to impose on Glogower the obligation to make up the difference out of his own pocket, from the 20% Administrative Fee. (App. A). The effect of the Ninth Circuit Memorandum

is as though Congress had enacted a new law, applicable to only Andy Glogower, which law conflicts with prior law in the same circuit, is at odds with the express terms of 11 U.S.C. § 523(a)(4), and cannot be cited for any purpose in any other bankruptcy case. The Panel's conclusion that the 80% Claims portion was insufficient to pay claims was not only irrelevant, but constituted an *ad hoc* imposition of non-dischargeability, a result forbidden by the Bankruptcy Clause and applicable decisions of this Court. Accordingly, the Ninth Circuit interpretation and application of § 523(a)(4) "repugnant" to Art. I, § 8, cl. 4, of the Constitution. 455 U.S. at 458.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted, the Ninth Circuit Memorandum reversed, the District Court Order affirmed, and the matter remanded for further proceedings.

RESPECTFULLY SUBMITTED this 7th day of August, 2009.

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APPENDIX A

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 07-16188
D.C. No. CV-04-01724-RGS

[Filed April 3, 2009]

In the Matter of: ANDREW D. GLOGOWER,	)
Debtor,	)
SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators,	)
Appellant,	)
v.	)
ANDREW D. GLOGOWER,	)
Appellee.	)

Appeal from the United States District Court
for the District of Arizona
Roger G. Strand, District Judge, Presiding

Argued and Submitted February 12, 2009
San Francisco, California

MEMORANDUM*

Before: D.W. NELSON, W. FLETCHER and TALLMAN, Circuit Judges.

The Commissioner of the Kentucky Department of Insurance, Sharon P. Clark, serves as Liquidator ("Liquidator") of National Business Association Trust ("NBAT") and National Business Association ("NBA"). The Liquidator appeals the district court's determination that Andrew Glogower ("Glogower") is entitled to a discharge in his Chapter 7 bankruptcy proceeding for payments made to him by NBA. These challenged payments consist of a $362,282.70 bonus payment ("Bonus Payment") and a series of payments totaling $395,000 in partial satisfaction of a promissory note executed between Glogower and NBA ("Loan Payments"). We agree with the bankruptcy court and hold that the Bonus Payment and Loan Payments are non-dischargeable in bankruptcy under 11 U.S.C. § 523(a)(4). We therefore reverse the district court.

"[W]e independently review the bankruptcy court's decision, without giving deference to the district court." *In re Rosson*, 545 F.3d 764, 770 (9th Cir. 2008). "Whether a claim is nondischargeable presents mixed issues of law and fact and is [ ] reviewed de novo." *In re Barboza*, 545 F.3d 702, 706 (9th Cir. 2008).

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* This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36-3.

As a threshold matter, we must decide whether the Bonus Payment was properly before the bankruptcy court, as the district court did not reach this issue in its determination. Glogower argues that the issue of dischargeability with regard to the Bonus Payment was outside the scope of the Pretrial Statement and must therefore be excluded from any finding of non-dischargeability. This argument is without merit. The Pretrial Statement specifically lists the Bonus Payment as a stipulated material fact and raises the issue of whether the entire "State Court Judgment"—including the Bonus Payment Judgment—is dischargeable in bankruptcy. This is sufficient to find that Glogower had notice that the Liquidator planned to present evidence with regard to the dischargeability of the Bonus Payment. Because we hold that the issue was properly before the bankruptcy court, we examine the issue of dischargeability with regard to both the Bonus Payment and the Loan Payments.

Section 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity." We reject "[t]he broad, general definition of fiduciary—a relationship involving confidence, trust and good faith" in the bankruptcy discharge context. *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986). "Instead, the fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." *In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996). In *In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001), we held that a fiduciary under the Employee Retirement Income Security Act ("ERISA") is a fiduciary under § 523(a)(4).

The bankruptcy court correctly determined that Glogower was a fiduciary for purposes of § 523(a)(4) because he was an ERISA fiduciary. NBAT was an ERISA plan. Its Trust Agreement states that it was formed "consistent with [ERISA]." In prior litigation, NBAT took the position that it was an ERISA plan and the District Court for the Western District of Kentucky agreed. *Nat'l Bus. Assoc. Trust v. Morgan*, 770 F. Supp. 1169, 1171, 1175 (W.D. Ky. 1991). Glogower also admitted in his testimony before the bankruptcy court that NBAT was an ERISA plan.

Glogower was an ERISA fiduciary of NBAT. ERISA provides that

> a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets . . . .

29 U.S.C. § 1002(21)(A). Glogower had total control over NBA as its chief executive officer, chairman of the board, and majority shareholder, and NBA was given a significant amount of discretionary authority over the management and asset disposition of NBAT.

We reject Glogower's argument that because the Bonus Payment and Loan Payments were paid out of a separate administrative account they were not made in violation of his fiduciary duty. The Franklin County Circuit Court of Kentucky determined that NBAT and NBA were one and the same entity. We owe full faith and credit to this factual determination. *See generally Yeoman v. Commonwealth, Health Policy Bd.*, 983

S.W.2d 459 (Ky. 1998). Once the corporate veil has been pierced, there is no legally relevant distinction between the funds used to pay NBA and the funds used to pay beneficiaries.

The bankruptcy court also properly determined that the Loan Payments and Bonus Payments constituted defalcations under § 523(a)(4). The term "defalcation" as used in § 523(a)(4) means either the "misappropriation of trust funds or money held in any fiduciary capacity" or the "failure to properly account for such funds." *In re Hemmeter*, 242 F.3d at 1190. "[N]o intent to defraud is required" to find defalcation. *Id.* The bankruptcy court correctly concluded that Glogower misappropriated funds he held in a fiduciary capacity by "pay[ing] himself when he was fully aware that the entities (NBAT/NBA) he controlled could not pay the claims due the plan beneficiaries."

The judgment of the district court is vacated and the case is remanded with instructions to reinstate the judgment of the bankruptcy court.

REVERSED AND REMANDED.

APPENDIX B

WO

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

No. CV 04-1724-PHX-RGS
BK-00-06179-PHX-RTB
ADV. No. 00-681

[Filed May 31, 2007]

IN THE MATTER OF Andrew D. Glogower, Debtor,	)
Andrew D. Glogower, Appellant/Cross-Appellee, vs. Janie A. Miller, Appellee/Cross-Appellant.	)

ORDER

Pending before the Court is Debtor Andrew D. Glogower's ("Debtor's") appeal and Liquidator Janie A.

Miller's ("Liquidator's") cross-appeal from a final judgment of the United States Bankruptcy Court entered on July 9, 2004. Following oral argument on December 5, 2005, the Court took the matter under advisement. Having considered the written and oral arguments of the parties, the applicable law, and the record before it, the Court now rules.

I. BACKGROUND

The parties stipulated to the following material facts, as set forth in the Joint Pretrial Statement. [Bankruptcy Docket ("Doc.") # 64]

National Business Association Trust ("NBAT") was an express trust created for the sole purpose of providing healthcare benefits under certain identified health plans. National Benefit Administrators, Inc. ("NBA") was the administrator of NBAT. The Debtor served as secretary and treasurer of NBA from 1982 through 1987 and was appointed chairman of the board and chief executive officer on September 1, 1988.

In September 1988, while acting as director of NBA, the Debtor approved a resolution authorizing execution of a $485,297.30 promissory note from NBA to himself for accrued but unpaid salary. NBA made payments (the "Loan Payments") to the Debtor in partial satisfaction of the promissory note on November 6, 1989, November 8, 1989, December 5, 1989, and April 26, 1990, in the total amount of $395,000.00. In June 1989, while acting as director of NBA, the Debtor approved a resolution authorizing a bonus payment (the "Bonus Payment") of $362,282.70 from NBA to himself.

On June 20, 1991, the Franklin Circuit Court, Commonwealth of Kentucky (the "Kentucky Court"), found that NBAT was an unauthorized insurer doing business in Kentucky, that NBAT was insolvent, and that further transaction of business would be hazardous financially and otherwise to its policyholders, claimants, and other creditors. Accordingly, on that date, the Kentucky Court ordered the liquidation of NBAT.

On May 9, 1995, the Kentucky Court found that NBA had complete and exclusive authority to market NBAT coverage, to set and collect premiums for NBAT coverage, to receive, adjust, and settle claims under NBAT coverage, to execute documents in the name of NBAT, to receive service of legal process on behalf of NBAT as designated agent, and to otherwise transact the business of NBAT. Accordingly, the Kentucky Court found that NBAT "acted through and as one with NBA" and thus were a single entity. On that date, the Kentucky Court found that NBA was insolvent.

On August 31, 1999, the Kentucky Court entered judgment in the amount of $395,000.00 against the Debtor and in favor of the Liquidator. On October 6, 1999, that court amended the judgment to include prejudgment interest, for a total amount of $833,488.00.

The following facts are found in the record. The Debtor filed a Petition for Relief under Chapter 7 of the United States Bankruptcy Code. On October 6, 2000, the then-Liquidator of NBAT and NBA filed an adversary complaint pursuant to 11 U.S.C. § 523, seeking to deny the Debtor a discharge of certain debts, including the Kentucky judgment described

above. The adversary complaint alleged that the Debtor is not entitled to a discharge pursuant to 11 U.S.C. § 523(a)(2)(A) (false representations or fraud) (Count 1); 11 U.S.C. § 523(a)(4) (defalcation) (Count 2); and 11 U.S.C. § 523(a)(6) (intentional or malicious conduct) (Count 3). [Doc. # 1]

On November 16, 2000, the Debtor filed a Motion for Partial Summary Judgment, alleging that the Kentucky Judgment was dischargeable on the grounds that there were no findings of false representation, fraud, or delfalcation while acting in a fiduciary capacity. [Doc. # 5, 6] The Liquidator filed a response and cross-motion for summary judgment, arguing that the Kentucky judgment was binding and that the debt is nondischargeable under the three enumerated sections of 11 U.S.C. § 523. [Doc. # 11, 12] Following oral argument on the matter, the Bankruptcy Court denied the Debtor's motion and granted the Liquidator's motion. [Doc. # 24] In its order, the Bankruptcy Court concluded that *In re Penick*, 199 B.R. 16 (Bankr. E.D. Ky), *rev'd*, 149 F.3d 1184 (6th Cir. 1998) (unpublished), *cert. denied*, 119 S. Ct. 618, 142 L. Ed. 2d 558 (1999), is the controlling law in this case. The Bankruptcy Court, however, mistakenly interpreted that decision as a reversal of the lower court's decision to dismiss the creditor's claims.

The Debtor filed a Motion for Reconsideration and a separate memorandum regarding *In re Penick*, pointing out that, contrary to the Bankruptcy Court's interpretation, the *Penick* case resulted in reinstatement of the bankruptcy court's dismissal of the creditor's complaint against the *Penick* debtor. The Debtor argued that there was no evidence in the record of fraud or defalcation by the Debtor in the instant

case. The Bankruptcy Court granted the Motion for Reconsideration and vacated its prior order granting the Liquidator's Motion for Summary Judgment. [Doc. # 38] The Court stated that it was not clear at the initial ruling that the district court in *Penick* had reversed the bankruptcy court, and that, thereafter, the Sixth Circuit had reversed the district court and reinstated the bankruptcy court's decision. The Bankruptcy Court again concluded that it "should follow that decision," but now determined that under *Penick*, transfers of corporate assets to its principals do not trigger the nondischargeability provisions of 11 U.S.C. § 523(a). The Liquidator filed a Motion to Reconsider, agreeing that *In re Penick* is the controlling law, but arguing that the application of *Penick* supported a judgment in the Liquidator's favor. [Doc. # 47] After hearing oral arguments on the matter, the Bankruptcy Court denied the Liquidator's Motion for Reconsideration, stating that neither party was entitled to summary judgment. [Doc. # 66]

On February 12, 2002, the parties filed their Joint Pretrial Statement. [Doc. # 64] On February 26, 2002, the Liquidator filed a Motion for Partial Summary Judgment, alleging that because it was established by the Kentucky Court that the Debtor was pursuing and directing the activities of an unauthorized insurer, Kentucky law mandated that the Debtor should be held liable for all unpaid claims or losses incurred. The Liquidator further argued that this debt was nondischargeable pursuant to 11 U.S.C. § 523. The Bankruptcy Court denied the motion. [Doc. # 86]

On July 15, 2002, the Liquidator filed a Statement of Damages. These damages included (1) the Kentucky Judgment in the amount of $833,488.00; (2) the Bonus

Payment in the amount of $362,282.70; (3) transfers from NBA to Debtor and other individuals in the corporation, and to other creditors in the amount of $361,221.76, and (4) 4,010 unpaid claims, which totaled approximately $10,259,656.42.

On January 23, 2003, the Liquidator filed a Renewed Motion for Partial Summary Judgment, agreeing that *Penick* is controlling and arguing that the debt owed by the Debtor was nondischargeable. [Doc. # 99] The Bankruptcy Court denied the motion.

The Liquidator filed a Motion in Limine to preclude the Debtor from introducing evidence that NBAT and NBA were separate legal entities under the doctrine of collateral estoppel because the Kentucky Court had held that they were a single entity. [Doc. # 104]

On March 3, 2003, a three-day trial commenced before the Honorable Redfield T. Baum. On the first day of trial, the Court granted the Liquidator's Motion in Limine. At the conclusion of the evidence, the parties submitted post-trial briefs, and the Court heard closing arguments. Thereafter, the Court took the matter under advisement.

On September 17, 2003, the Bankruptcy Court issued its decision, finding that the June 1989 Bonus Payment of $362,282.70 and the Loan Payments paid between November 1989 and April 1990 totaling $395,000.00 were not dischargeable under Section 523(a)(4). [Doc. # 129] The Court described that portion of the claim for defalcation in a fiduciary capacity as easily decided. Citing *In re Hemmeter*, 242 F.3d 1186 (9th Cir. 2001), the Bankruptcy Court stated that defalcation includes both the misappropriation of

trust funds or money held in any fiduciary capacity and the failure to properly account for such funds. Regardless of intent, the Court continued, defalcation under § 523(a)(4) "is a failure to produce funds entrusted to a fiduciary." The Court concluded that the Bonus Payment and the Loan Payments to the Debtor "constituted defalcations while he was acting in a fiduciary capacity rendering such obligations not dischargeable in his bankruptcy case."

The Bankruptcy Court also concluded that the Debtor's "apparent liability for all of the unpaid claims of NBAT . . . is dischargeable in bankruptcy." Citing *In re Penick*, the Court stated that "[t]he essence of defalcation for bankruptcy discharge purposes is the failure to produce funds entrusted to a fiduciary. This concept does not embrace the normal acts within the business judgment of the fiduciary that, however flawed, do not involve the failure to account for or produce a beneficiary's funds." The Court found that NBAT and NBA could account for or produce the funds entrusted to it. The Court agreed with the conclusion of the U.S. Department of Labor that this was not a case where a subject actively misled the trustees. The Court stated that the NBAT employee benefit program "was simply underfunded by the employers from the outset and that is, at a minimum, one of the reasons for its ultimate and all but certain financial collapse."

The parties filed motions for reconsideration. In the Bankruptcy Court's March 24, 2004 order denying the Liquidator's Motion for Reconsideration, the Court stated that it agreed that the Debtor violated his fiduciary duty of disclosure when he failed to inform the beneficiaries and their employers of the severe financial distress of NBAT. However, the Bankruptcy

Court concluded that it could "not determine from this record the amount of any additional damages that should be declared not discharged . . . ." [Doc. # 149]

The Liquidator filed a Motion for Clarification seeking a finding that the Debtor breached his fiduciary duty to disclose in excess of the ruling already made by the Court in its March 24, 2004 decision or for an evidentiary hearing to determine any addition damages beyond the amounts already set by the Court. The Bankruptcy Court declined to make any further findings. The Court considered the motion for clarification to be a motion for new trial and denied it as being both procedurally and substantively deficient. [Doc. # 153]

On July 9, 2004, the Bankruptcy Court entered its Final Order and Judgment holding that (1) the $362,282.70 Bonus Payment and the Loan Payments of $395,000.00, as well as the applicable pre- and post-judgment thereon, were not dischargeable under 11 U.S.C. § 523(a)(4) because the Debtor committed defalcation in a fiduciary capacity; and (2) the Debtors apparent liability for all of the unpaid claims of NBAT was dischargeable in bankruptcy. [Doc. # 158]

The Debtor filed a timely appeal and the Liquidator filed a timely cross-appeal from the Bankruptcy Court's judgment.

II. ISSUES PRESENTED

A. Issues on Appeal

1. Whether Bankruptcy Court applied the correct standard in determining that the

Debtor's liability for the Bonus Payment and the Loan Payments was nondischargeable under 11 U.S.C. § 523(a)(4);

2. Whether there are sufficient facts in the record to support the Bankruptcy Courts finding that the Bonus Payment and the Loan Payments to the Debtor constituted defalcation while acting in a fiduciary capacity; and

3. Whether the issue regarding the nondischargeability of the Bonus Payment was properly before the Bankruptcy Court.

B. Issue on Cross-Appeal

Whether the Bankruptcy Court erred in finding that the Debtor's apparent liability for all of the unpaid claims of NBAT was dischargeable in bankruptcy.

III. STANDARD OF REVIEW

On appeal from a final judgment, the Court will review the Bankruptcy Court's factual findings for clear error and its legal conclusions *de novo*. *In re Barakat*, 99 F.3d 1520 (9th Cir. 1996).

IV. DISCUSSION

A. The Appeal

The Debtor argues that the Bankruptcy Court failed to apply the correct standard as set forth in *In re Penick* and by the Ninth Circuit in determining that the Debtor's liability for the Bonus Payment and the Loan Payments was nondischargeable under 11 U.S.C. § 523(a)(4). The Debtor asserts that although the Bankruptcy Court acknowledged that the *Penick* case was controlling authority, it ultimately applied an incorrect, and unduly broad, legal standard, i.e., that defalcation under § 523(a)(4) is simply a "failure to produce funds entrusted to a fiduciary."

Section 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity." The Ninth Circuit has held that "[t]he broad, general definition of fiduciary–a relationship involving confidence, trust and good faith–is inapplicable in the dischargeability context." *Ragsdale v. Haller*,780 F.2d 794, 796 (9th Cir.1986). Accordingly, in *In re Cantrell*, 329 F.3d 1119, 1125 (9th Cir. 2003), the Ninth Circuit stated that it has "adopted a narrow definition of 'fiduciary' for purposes of § 523(a)(4)." The *Cantrell* court explained that "'[T]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt.'" *Id.* (quoting *In re Lewis*, 997 F.3d 1182, 1185 (9th Cir. 1996)).

The rule adopted by the Sixth Circuit Court of Appeals, which encompasses the state of Kentucky, is the same as that in the Ninth Circuit. The Sixth Circuit has held that the term "fiduciary" under § 523(a)(4) "applies only to express or technical trusts and does not extend to implied trusts, which are imposed on transactions by operation of law as a

matter of equity." *In re Brady*, 101 F.3d 1165, 1173 (6th Cir. 1996); *Penick*, 199 B.R. at 20.

In *Penick*, the debtor, who was the sole officer, director and shareholder of W. Penick Electrical Construction Co., Inc., filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court, Eastern District of Kentucky on March 20, 1995. *Id.* at 18. From 1990 through 1994, the debtor withdrew money via "corporate" checks from the general checking account of Penick Electrical in irregular amounts for use a part from the electrical construction business. *Id.* The withdrawals were entered as loans or "shareholder receivables" on the records of Penick Electrical. *Id.* Peoples Bank made a series of loans to debtor's business. Proceeds from these loans were deposited directly into a general checking account in the name of Penick Electrical. *Id.* at 18-19. In early 1995, Penick Electrical ceased its operations. The business was unable to satisfy its financial obligations to Peoples Bank as those obligations became due. *Id.* at 19. Peoples Bank filed an adversary complaint and a motion for summary judgment, contending that, as a matter of law, the debt was nondischargeable pursuant to 11 U.S.C. § 523(a)(4) because the debtor engaged in defalcation while acting in a fiduciary capacity. *Id.*

The *Penick* court stated that the threshold question to be determined was whether the debtor met the definition of a fiduciary. That court relied on *In re Johnson*, 691 F.2d 249 (6th Cir. 1982), which it characterized as the leading case in the Sixth Circuit on the subject. The *Johnson* court, in interpreting § 17(a)(4) of the Bankruptcy Act, which was the predecessor of 11 U.S.C. §523(a)(4), held that "[t]he

term 'fiduciary' applies only to express or technical trusts and does not extend to implied trusts, which are imposed on transactions by operation of law as a matter of equity. . . . Moreover, the requisite trust relationship must exist prior to the act creating the debt, and without reference to it." *Johnson*, 691 F.2d at 251-52. The *Penick* court stated that it "must therefore discover the existence of a technical trust in order for the debtor to be considered a fiduciary." 199 B.R. at 20.

"Technical trusts are created by an agreement between the parties to impose a trust relationship, or by a statute that specifically imposes fiduciary obligations on a party." *Id.* The plaintiff in *Penick* relied on Kentucky Revised Statute 271B.6-400(3) to establish the trust relationship between the debtor and his creditors that would make the debtor a fiduciary. *Id.* That statute provides that no distribution shall be made if, after giving it effect, the corporation would not be able to pay its debts as they become due in the usual course of business, or if the corporation's total assets would be less than the sum of its total liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution. *Id.* The *Penick* court determined that this statute did not create a trust, even though it might infer that a corporate director has a "fiduciary" duty to the corporation's shareholders. *Id.*

The *Penick* court concluded that the plaintiff failed to meet its burden of proof under § 523(a)(4), which "requires the presence of an express trust in order for a debt to be held [non]dischargeable on the grounds

that the debtor engaged in a defalcation while acting in a fiduciary capacity." *Id.* at 20-21 (quoting *In re Sigler*, 196 B.R. 762, 768 (Bkrtcy. W.D. Ky. 1996)). Accordingly, the bankruptcy court found that the debt was not excepted from discharge. *Id.* at 21.

On appeal, the district court reversed *Penick*. However, in an unpublished decision, the Sixth Circuit Court of Appeals reversed the district court and reinstated the *Penick* bankruptcy court decision. *See In re Penick*, 149 F.3d 1184 (6th Cir. 1998). Thereafter, certiorari was denied. *Peoples Bank & Trust Co. of Hazard v. Penick*, 525 U.S. 1055, 119 S. Ct. 618, 142 L. Ed. 2d 58 (1998).

Although the Bankruptcy Court in the present case acknowledged the *Penick* case as controlling authority, the court failed to cite it or apply the standards set forth therein when it rendered its September 17, 2003 decision regarding the Bonus and Loan Payments. Instead, the Bankruptcy Court stated that "defalcation in the context of Section 523(a)(4) is a failure to produce funds entrusted to a fiduciary." The Bankruptcy Court found defalcation based upon the Debtor's conduct in paying himself at a time when NBAT did not have the financial resources to pay claims due to the plan beneficiaries. [Doc. # 129] The Bankruptcy Court, however, made no finding of an express trust, as required by controlling Sixth and Ninth Circuit law. The Bankruptcy Court instead relied on a general definition of a breach of fiduciary duty, a standard that "is inapplicable in the dischargeability context." *Ragsdale*, 780 F.2d at 796.

The Debtor also argues that there are insufficient facts in the record to support the Bankruptcy Court's

finding that the Bonus Payment and the Loan Payments constituted defalcations while acting in a fiduciary capacity. The Debtor points out that NBAT was created by Trust Agreement dated July 24, 1987. [Liquidator's Trial Ex. 9] On or about August 1, 1987, Douglas Walsh, as executive director of NBAT, and NBA, as plan supervisor, entered into an "Agreement for Plan Supervisor," whereby NBA was appointed plan supervisor to, among other things, "market, sell, promote or offer the Plan to employers and/or employees," approve claims, arrange for payment of claims from funds available to the plan, establish the level or amount of contributions to the plan, as well as other administrative tasks asset forth therein. [Liquidator's Trial Ex. 10, Section II] The Agreement for Plan Supervisor expressly provided that NBA is entitled to a fee of 20% of all contributions:

> The Plan Supervisor shall be entitled to a fee for its services to the Plan under this Agreement which shall be payable on a monthly basis and computed at the rate of twenty percent (20%) of all contributions, exclusive of life insurance contributions, received in a given month for all Plan participants who become such subsequent to August 1, 1987.

[*Id.*, Section IV]. The Agreement for Plan Supervisor further provided that NBA shall incur no liability for any act or failure to act not connected with the processing and payment of claims. The Agreement for Plan Supervisor was signed by Mr. Walsh as executive director of NBAT and by the Debtor on behalf of NBA. [*Id.*] The 20% administrative fee was placed in an NBA account for administration and the remaining 80% was placed in a separate NBAT account to pay claims.

The Debtor argues that he was not a trustee with respect to the 20% administrative fee and had no fiduciary duty with respect to the 20% fee, and accordingly, the Bonus and Loan Payments he made to himself from this fee did not constitute defalcation under 11 U.S.C. § 523(A)(4). The Debtor alleges that he owed a fiduciary duty only with respect to the 80% claims portion of the trust. As such, the Debtor maintains that he never received funds from the *res* of the trust because the payments he received were never intended to pay the claims of the plan participants.

The Liquidator argues that because the Bankruptcy Court adopted the Kentucky Court's decision that NBAT and NBA were a single entity, both entities became an express trust. The Liquidator fails to explain, however, how this decision made all funds held in an NBA account trust funds for purposes of § 523(a)(4). If such an effect had automatically occurred, there would have been no need for a trial on the issue of the dischargeability of the Bonus and Loan Payments. However, after the Bankruptcy Court granted the *motion in limine* on the "single entity" issue, it conducted a three-day trial to determine whether payments were improperly made out of an express trust. Moreover, the Court rejected the Liquidator's argument that the single entity issue was dispositive as to the question whether the Debtor was paid out of trust monies and denied her renewed motion for summary judgment on this basis. The Bankruptcy Court noted that under *Penick*, the key element in determining whether a judgment is nondischargeable pursuant to 11 U.S.C. § 523(a)(4) "is that the money was taken from a trust fund. . . . And so it would depend on the source of the funds paid to NBAT or NBA that were in turn paid to [the Debtor]."

The Court went on to state that "[o]f the funds that came in, twenty percent were to go to NBA to pay, in effect, their overhead and operations. And so I would presume at this point, that that's not a trust fund, that portion of it." [Doc. # 144, March Transcript, pp. 16-17]

The evidence in the record demonstrates that, as to the 20% Administrative Fee, an express trust was not created: there was (1) no intent to create a trust; (2) no trustee; (3) no trust *res*; and (4) no definite beneficiary. *See In re Blaszak*, 397 F.3d 386, 391-92 (6th Cir. 2005). In an arms-length negotiated agreement, NBA, as plan supervisor, was entitled to take the 20% fee for administrative services. [Liquidator's Trial Ex. 10, Section IV] The plan supervisor could use this money for any purpose, including payment of salaries, bonuses, or compensation to its owners. [Doc. # 145, March 5 Transcript, pp. 18-19] A review of the evidence presented at trial demonstrates that the 20% Administrative Fee was kept in an account separate from the 80% claims portion. Accordingly, there is no evidence in the record to support a finding that with respect to the 20% Administrative Fee, there was an intent to create a trust, that the Debtor was a trustee, that the 20% fee was part of a trust *res*, or that there was a beneficiary -- the evidence demonstrates that it was intended to be the Debtor's money. Moreover, the evidence presented at trial shows that the Debtor received the Bonus Payment and the Loan Payments from the separate account holding the 20% Administrative Fee. In fact, the Liquidator's attorney admitted that the Debtor received no money from the 80% claims portion:

> THE COURT: [A]re you going to put on evidence that he paid this money out of an express trust fund?
>
> MR. JORDAN: The checks did not come out of NBAT's account.

Accordingly, based on the foregoing, the Liquidator failed to meet its burden of establishing the existence of an express trust, and the Bankruptcy Court therefore erred in denying the Debtor a discharge under § 523(a)(4) with respect to the Bonus Payment and the Loan Payments.

In light of the Court's determination above, the Court need not reach the issue whether the nondischargeability of the Bonus Payment was properly before the Bankruptcy Court.

B. The Cross-Appeal

The Liquidator argues that the Bankruptcy Court erred in failing to hold the Debtor's liability for all unpaid claims and losses of NBAT/NBA nondischargeable in bankruptcy. As discussed previously, in its September 17, 2003 order [Doc. # 129], the Bankruptcy Court concluded that the Debtor's "apparent liability for all of the unpaid claims of NBAT . . . is dischargeable in bankruptcy." Citing *In re Hemmeter* and *In re Penick*, the Court stated that "[t]he essence of defalcation for bankruptcy discharge purposes is the failure to produce funds entrusted to a fiduciary. This concept does not embrace the normal acts within the business judgment of the fiduciary that, however flawed, do not involve the failure to account for or produce a beneficiary's funds." The

Bankruptcy Court found that NBAT and NBA could account for or produce the funds entrusted to it. The Court agreed with the conclusion of the U.S. Department of Labor that this was not a case where a subject actively misled the trustees. The Court stated that the NBAT employee benefit program "was simply underfunded by the employers from the outset and that is, at a minimum, one of the reasons for its ultimate and all but certain financial collapse."

The parties filed motions for reconsideration. In the Bankruptcy Court's March 24, 2004 order denying the Liquidator's Motion for Reconsideration [Doc. # 149], the Court stated that it agreed that the Debtor violated his fiduciary duty of disclosure when he failed to inform the beneficiaries and their employers of the severe financial distress of NBAT. However, the Bankruptcy Court concluded that it could "not determine from this record the amount of any additional damages that should be declared not discharged . . . ."

The Bankruptcy Court noted that "this case was not tried based upon the theory of failure to disclose and the damages caused by such failure. Thus there was no damage presentation or exhibit which shows the losses that were incurred after a duty to disclose." The Bankruptcy Court further noted that it was not clear when the duty to disclose arose. The Court stated that the total losses "appear excessive" and pointed out one claim for over one million dollars that appeared to be invalid. Thus, the Bankruptcy Court found that it lacked an evidentiary basis to begin calculating damages. The Court also stated that it had a strong sense that not all of the damages suffered should be assessed to the Debtor and noted that the employers

who turned over their employee benefit plans were "in part responsible for some portion of damages because they apparently failed to ensure that NBAT was able to pay the claims of their employees." Thereafter, the Bankruptcy Court concluded that the Debtor's apparent liability for all of the unpaid claims of NBAT to be dischargeable in bankruptcy.

Assuming without deciding that the Debtor violated his fiduciary duty of disclosure when he failed to inform the beneficiaries and their employers of the severe financial distress of NBAT and thus created potential nondischargeable liability under section 523(a)(4) with respect to subsequent unpaid benefit claims, this Court, sitting as an appellate court, is not in a position to make a determination of the amount of damages to be assessed based on the record before it. The Court agrees with the reasoning of the Bankruptcy Court that because this case was not tried based upon the theory of failure to disclose and the damages caused by such failure, there is insufficient evidence in the record to ascertain precise damages. Accordingly, the Court will affirm the Bankruptcy Court's judgment with respect to this issue.

IV. CONCLUSION

Based on the foregoing,

IT IS ORDERED reversing that part of the Bankruptcy Court's July 9, 2004 Order finding the $362,282.70 Bonus Payment and the Loan Payments of $395,000.00, as well as the applicable pre- and post-judgment interest thereon, not dischargeable under 11 U.S.C. § 523(a)(4). [Doc. # 158]

IT IS FURTHER ORDERED affirming that part of the Bankruptcy Court's July 9, 2004 Order finding that the Debtor's apparent liability for all of the unpaid claims of NBAT was dischargeable in bankruptcy. [Doc. # 158]

In light of the Court's ruling above,

IT IS FURTHER ORDERED denying Appellant's Motion to Strike as moot. [Doc. # 18]

DATED this 25th day of May, 2007.

/s/
Roger G. Strand
Senior United States District Judge

APPENDIX C

UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA
PHOENIX DIVISION

CHAPTER: 7
CASE NO. 00-06179-PHX-RTE
ADV. NO. 00-681

[Filed July 9, 2004]

IN RE: ANDREW D. GLOGOWER,	)
	)
Debtor,	)
	)
JANIE A. MILLER, LIQUIDATOR OF NATIONAL BUSINESS ASSOCIATION TRUST and NATIONAL BENEFIT ADMINISTRATORS, INC.,	)
	)
Movant,	)
	)
vs.	)
	)
ANDREW D. GLOGOWER,	)
	)
Debtor/Respondent.	)
	)

FINAL ORDER AND JUDGMENT

This matter was heard before the Court on March 3-5, 2003. Following supplemental briefing, this Court issued a Minute Entry/Order on September 17, 2003, in which it was held that some, but not all, of the Liquidator's claims against the Debtor were not dischargeable in bankruptcy. On September 22, 2003. the Debtor filed a Motion to Reconsider, and on September 26, 2003, the Liquidator filed its Motion to Reconsider. On December 11, 2003, this Court denied the Debtor's Motion for Reconsideration and took the Liquidator's Motion under advisement. Following additional briefing, this Court entered a Minute Entry/Order denying the Liquidator's Motion to Reconsider or March 24, 2004. On March 31, 2004, the Liquidator filed a Motion for Clarification with regard to this Court's March 24, 2004 Minute Entry/Order. On May 18, 2004, this Court entered an Order denying the Liquidator's Motions to Reconsider and for Clarification.

WHEREFORE, the Liquidator's 11 U.S.C. § 523 Complaint having come before the Court for hearing, the parties having submitted briefs on the issues raised therein, the Court having reviewed the evidence, and heard witness testimony and arguments of counsel and otherwise being sufficiently advised, hereby Finds and Orders in accordance with the Minute Entry/Order entered September 17, 2003 as follows:

1. The June 16, 1989 bonus payment of $362,282.70 and the loan payments, paid between November 1989 and April 1990, totaling $395,000.00, as well as the applicable pre- and post-judgment thereon, are not dischargeable in bankruptcy under

11 U.S.C. § 523(a)(4) as the Debtor committed defalcation in a fiduciary capacity in obtaining same.

2. This Court finds and concludes that the Debtor's apparent liability for all of the unpaid claims of NBAT, except as itemized above, is dischargeable in bankruptcy.

3. That this Final Order and Judgment is final and appealable, as there is no just cause for delay.

DATED this 9 day of July, 2004.

/s/
Honorable Redfield T. Baum
U.S. Bankruptcy Judge

* * *

[Certificate of Service omitted in printing of this appendix]

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 07-16188
D.C. No. CV-04-01724-RGS
District of Arizona, Phoenix

[Filed May 11, 2009]

In the Matter of: ANDREW D. GLOGOWER,	)
Debtor,	)
SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators,	)
Appellant,	)
v.	)
ANDREW D. GLOGOWER,	)
Appellee.	)

ORDER

Before: D.W. NELSON, W. FLETCHER and TALLMAN, Circuit Judges.

The panel has voted to deny the petition for rehearing. Judges Fletcher and Tallman have voted to deny the petition for rehearing en banc; and Judge Nelson so recommends.

The full court has been advised of the petition for rehearing en banc and no judge of the court has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing and the petition for rehearing en banc, filed April 16, 2009, are DENIED.

The motion for leave to file appendix in support of petition for rehearing and petition for rehearing en banc is DENIED as moot.

APPENDIX E

Constitution and Statutes

Constitution of the United States
Article I, The Congress, Section 8, Clause 4.
Naturalization and Bankruptcy

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—
(A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
(B) with respect to which a return, or equivalent report or notice, if required—
(i) was not filed or given; or
(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C) (i) for purposes of subparagraph (A)—

(I) consumer debts owed to a single creditor and aggregating more than $550[1] for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and

(II) cash advances aggregating more than $825[1] that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and

(ii) for purposes of this subparagraph—

(I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and

(II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor.

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) for a domestic support obligation;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

(9) for death or personal injury caused by the debtor's operation of a motor vehicle, vessel, or aircraft if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

(10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge

under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

(12) for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency;

(13) for any payment of an order of restitution issued under title 18, United States Code;

(14) incurred to pay a tax to the United States that would be nondischargeable pursuant to paragraph (1);

(14A) incurred to pay a tax to a governmental unit, other than the United States, that would be nondischargeable under paragraph (1);

(14B) incurred to pay fines or penalties imposed under Federal election law;

(15) to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit;

(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

(17) for a fee imposed on a prisoner by any court for the filing of a case, motion, complaint, or appeal, or for other costs and expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under subsection (b) or (f)(2) of section 1915 of title 28 (or a similar non-Federal law), or the debtor's status as a prisoner, as defined in section 1915(h) of title 28 (or a similar non-Federal law);

(18) owed to a pension, profit-sharing, stock bonus, or other plan established under section 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code of 1986, under—

(A) a loan permitted under section 408(b)(1) of the Employee Retirement Income Security Act of 1974, or subject to section 72(p) of the Internal Revenue Code of 1986; or
(B) a loan from a thrift savings plan permitted under subchapter III of chapter 84 of title 5, that satisfies the requirements of section 8433(g) of such title;

but nothing in this paragraph may be construed to provide that any loan made under a governmental plan under section 414(d), or a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title; or

(19) that—
(A) is for—
(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or
(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and
(B) results, before, on, or after the date on which the petition was filed, from—
(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
(ii) any settlement agreement entered into by the debtor; or
(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement

payment, attorney fee, cost, or other payment owed by the debtor.

For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act, under section 439A of the Higher Education Act of 1965, or under section 733(g) of the Public Health Service Act in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c) (1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator, or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

(e) Any institution-affiliated party of an insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11).

11 U.S.C. § 727. Discharge

(a) The court shall grant the debtor a discharge, unless—

(1) the debtor is not an individual;

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

(4) the debtor knowingly and fraudulently, in or in connection with the case—

(A) made a false oath or account;

(B) presented or used a false claim;

(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books,

documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case—

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

(8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case

commenced within 8 years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under section 1228 or 1328 of this title, or under section 660 or 661 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and

(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort;

(10) the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter;

(11) after filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in section 111, except that this paragraph shall not apply with respect to a debtor who is a person described in section 109(h)(4) or who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later

than 1 year after the date of such determination, and not less frequently than annually thereafter.); or

(12) the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is reasonable cause to believe that—

(A) section 522(q)(1) may be applicable to the debtor; and

(B) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

(c) (1) The trustee, a creditor, or the United States trustee may object to the granting of a discharge under subsection (a) of this section.

(2) On request of a party in interest, the court may order the trustee to examine the acts and conduct

of the debtor to determine whether a ground exists for denial of discharge.

(d) On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if—

(1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

(2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee;

(3) the debtor committed an act specified in subsection (a)(6) of this section; or

(4) the debtor has failed to explain satisfactorily—

(A) a material misstatement in an audit referred to in section 586(f) of title 28; or

(B) a failure to make available for inspection all necessary accounts, papers, documents, financial records, files, and all other papers, things, or property belonging to the debtor that are requested for an audit referred to in section 586(f) of title 28.

(e) The trustee, a creditor, or the United States trustee may request a revocation of a discharge—

(1) under subsection (d)(1) of this section within one year after such discharge is granted; or

(2) under subsection (d)(2) or (d)(3) of this section before the later of—

(A) one year after the granting of such discharge; and

(B) the date the case is closed.

APPENDIX F

Agreement For Plan Supervisor

TRIAL 000256, 000260
ER 13, 17

[*see fold-out exhibit next 2 pages*]

AGREEMENT FOR PLAN SUPERVISOR

BEST AVAILABLE COPY

SECTION IV.

COSTS OF ADMINISTRATION

The Plan Supervisor shall be entitled to a fee for its services to the Plan under this Agreement which shall be payable on a monthly basis and computed at the rate of twenty percent (20%) of all contributions, exclusive of life insurance contributions, received in a given month for all Plan participants who become such subsequent to August 1, 1987. A sum equal to two percent (2%) of the fee received by the Plan Supervisor hereunder shall be applied to the cost of operation of the Executive Director's office and paid to him on a monthly basis.

These fees shall be due and payable monthly when participation changes are reported as indicated in Section V. paragraph 5.1.

SECTION V.

THE COMPANY

5.1 As of the effective date of this Agreement, if requested, the Company shall provide the Plan Supervisor with a complete list of all employees of the Company who are eligible for benefits from the Plan. Thereafter, the Company shall notify the Plan Supervisor on a monthly basis of all changes in participation whether by reason of termination, change in classification, or any reason.

5.2 The Company shall collect the contributions, if any, made by the employees of the Plan in the manner it may deem appropriate and shall transfer the money so collected to the Plan on a monthly or more frequent basis. The Company, upon notice from the Plan Supervisor, shall pay to the Plan in the manner obligated to pay under the terms of the Plan.

5.3 The Company shall assist in the enrollment of the employees in the Plan, co-operate with the Plan Supervisor with regard to proper settlement of claims, and transmit any inquiries pertaining to the Plan to the Plan Supervisor. The Company shall maintain a supply of forms, enrollment cards or other documents and shall distribute or make available such documents to the employees.

5.4 The Company shall provide directly or through the Plan all materials and documents, including summaries for employees, reports and application and notice forms, as may be necessary or convenient for the operation of the Plan or to satisfy the requirements of governing law as might from time to time be

TRIAL 000260

EP 17

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APPENDIX G

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION II

90-CI-01207

[Dated June 20, 1991]

ELIZABETH P. WRIGHT,
COMMISSIONER OF THE KENTUCKY
DEPARTMENT OF INSURANCE
PETITIONER

v.

NATIONAL BUSINESS ASSOCIATION
TRUST

and

NATIONAL BENEFIT
ADMINISTRATORS, INC.

and

BENEFAX CORPORATION
RESPONDENTS

ORDER DIRECTING LIQUIDATION OF
NATIONAL BUSINESS ASSOCIATION TRUST

AND DENYING NATIONAL BUSINESS ASSOCIATION TRUST'S MOTION FOR SUMMARY JUDGMENT

Whereas, petitioner Elizabeth P. Wright, Commissioner of the Kentucky Department of Insurance ("Commissioner"), having conducted as thorough an examination as possible into the financial condition of respondent National Business Association Trust ("NBAT");

Whereas, the Commissioner has filed a verified petition for an order directing the liquidation of the respondent; and

Whereas, NBAT has moved for summary judgment on the ground that the petitioner lacks authority to regulate and/or liquidate NBAT in that NBAT is not subject to the jurisdiction of the Insurance Department; and

Whereas, the Court being sufficiently advised and finding that:

1. NBAT is an unauthorized insurer doing business in Kentucky. Due to the loss of its administration contract with NBA and NBA closing its doors, NBAT has no principal offices;

2. NBAT is or may be insolvent;

3. Attempts by the Commissioner to rehabilitate NBAT would be futile and would substantially increase the risk of loss to policyholders and claimants;

4. NBAT is in such financial condition that further transaction of business would be hazardous financially and otherwise to its policyholders, claimants, and other creditors, and to the public in general;

5. Adequate notice and service was made and given to the respondent by service on its attorney or agent for service of process.

THEREFORE, pursuant to KRS 304.33-190 and all other applicable law, IT IS ORDERED AND ADJUDGED that:

1. The Commissioner's motion for an order directing the liquidation of NBAT is GRANTED in all respects;

2. The respondent National Business Association Trust's motion for summary judgment is DENIED;

3. NBAT is insolvent;

4. The Commissioner and her successors in office are appointed liquidator of NBAT and are authorized and directed to take possession of the property of NBAT. The Commissioner is further directed to deal with the property and business of NBAT in the name of the Commissioner, and is vested with title to all property, contracts, rights of action, books, and records of NBAT, wherever located;

5. Formal notice of this order shall be given by the Commissioner by first class mail as prescribed in KRS 304.33-250 to all policyholders, claimants, creditors, and all other persons or entities having any unsatisfied claim or demand of any character against NBAT as disclosed by the books and records of NBAT in the

possession of the Commissioner at the last known address of such persons as disclosed by the books and records, or to my agent or intermediary acting on behalf of potential creditors as directed by any existing treaty or contract in such manner and form as the Commissioner, in her discretion, may find desirable, demanding that all persons indebted to NBAT render accounts of their indebtedness and pay any sums due to the Commissioner, as liquidator. The notice shall further notify creditors to present proofs of claim to the Commissioner, as liquidator, at a time specified within the notice within six months of the effective date of this order, but no later than one year from the effective date of this order. The notice may also contain such other rules, regulations, and information as the Commissioner, as liquidator, may deem necessary for the purpose of this proceeding in fixing and determining all lawful and valid claims and demands against NBAT;

6. The notice referred to in the preceding paragraph shall be given by publication in the Louisville Courier-Journal beginning as soon as practicable after the effective date of this order, and thereafter once a week for six (6) successive weeks;

7. The Notice of liquidation shall be given by publication in such other newspapers and at such times as selected by the Commissioner, as she deems necessary;

8. The notice prescribed in the preceding paragraphs is sufficient notice to all persons interested in the assets of NBAT;

9. All outstanding policies and other insurance obligations of NBAT terminate and all liability thereunder ceases and is fixed as of the date specified in KRS 304.33-210;

10. The rights and liabilities of policyholders, shareholders, and all other persons interested in the estate of NBAT are fixed as of the date of filing of the motion for liquidation, except as provided in the preceding paragraph and in KRS 304.33-210 and 304.33-380;

11. The Commissioner or her successors in office are authorized; permitted and allowed to sell, assign, and transfer any and all stocks, bonds, and securities in her possession or which may hereafter come into her possession belonging to NBAT at market price or better, or when there is no market price at the best price obtainable, at private sale and at such times and upon such terms and conditions as the Commissioner, in her discretion, deems for the best interest of the creditors of NBAT, and that the Commissioner is authorized, permitted, and allowed to take such steps and to make and execute such agreements and other documents as may be necessary to effect and carry out such sales, transfers and assignments;

12. NBA, NBAT, and BeneFax and their officers, directors, trustees, policyholders, agents, employees, managers, and all other persons having property or records belonging to NBAT are directed to assign, transfer, and deliver to the Commissioner, as liquidator, all such property and that any persons, firms, or corporations having any books, papers, or records relating to the business of NBAT shall preserve

them and submit them to the Commissioner, as liquidator, for examination at all reasonable times;

13. The officers, directors, trustees, policyholders, shareholders, managers, and employees of NBA, NBAT, and BeneFax and all other persons are enjoined and restrained from any further transaction of business or from dealing with or disposing of the property or assets of NBAT, or doing or permitting to be done any act or thing which might waste NBAT property or assets or allow or suffer the obtaining of preferences; judgments, attachments, or other liens, or the making of any levy against NBAT, or its estate while in possession and control of the Commissioner, as liquidator;

14. The officers, directors, trustees, policyholders, agents, shareholders, managers, and employees of NBA, NBAT, and BeneFax, and all other persons, including but not limited to, claimants, plaintiffs, and petitioners who have claims against NBAT are permanently enjoined and restrained from bringing or further prosecuting any action at law, suit and equity, special or other proceeding against NBAT or its estate, or the Commissioner and her successors in office, as liquidator thereof, or from making or executing any levy upon the property or estate of NBAT, or from in any way interfering with the Commissioner, or any successor in office, in her possession of the assets of NBAT, or the discharge of her duties as liquidator of NBAT, or in the liquidation of the business of NBAT, unless leave is granted by this Court;

15. The Commissioner, as liquidator, shall honor and pay in full and in priority all expenses incurred by

or at the direction of the Commissioner, as liquidator, as the expenses of administration;

16. The Commissioner shall submit for the Court's approval the names and compensation of any special deputies or counsel to the liquidator;

17. The Commissioner, as liquidator, or her special deputies, counsel, or other designee shall report to the Court on the process of the liquidation of NBAT on a quarterly basis and at such other times as the Court may direct;

18. Nothing herein shall in any way limit the powers or authority given to the Commissioner, as liquidator, in KRS Chapter 304.33 and other applicable laws, and

19. The Commissioner, as liquidator, may at any time make further application for such further or different relief as she sees fit.

This order directing the liquidation of NBAT shall be effective as of 20 June, 1991. This is a final and appealable order and there is no just cause for delay.

SO ORDERED THIS 20th day of JUNE, 1991.

/s/
JUDGE, FRANKLIN CIRCUIT COURT

APPENDIX H

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION II

90-CI-01207

[Filed May 10, 1991]

ELIZABETH P. WRIGHT,	)
COMMISSIONER OF THE KENTUCKY	)
DEPARTMENT OF INSURANCE[1]	)
PETITIONER	)
	)
v.	)
	)
NATIONAL BUSINESS ASSOCIATION	)
TRUST	)
	)
and	)
	)
NATIONAL BENEFIT	)
ADMINISTRATORS, INC.	)
	)
and	)
	)
BENEFAX CORPORATION	)
RESPONDENTS	)

[1] The Commissioner of the Kentucky Department of Insurances is now Don W. Stephens.

and	)
	)
STOCK YARDS BANK AND	)
TRUST COMPANY	)
INTERVENING RESPONDENT	)
	)
and	)
	)
HERITAGE HEALTH, INC.	)
RESPONDENT	)
	)

ORDER

This action comes before the court upon Petitioner's motion for summary judgment. On June 20, 1991, this court placed National Business Association Trust ("NBAT") into liquidation. That ruling has not been overturned and all statutory limitations for appeal have expired. Petitioner now seeks a ruling from this Court on two issues: (1) the liquidation of National Benefit Administrators, Inc. ("NBA") and (2) the single identity of NBA and NBAT. This matter has been fully briefed, placed under submission on March 22, 1995, and is now ripe for decision.

Petitioner alleges that there is no distinction between NBA and NBAT. In support of his contention, Petitioner asserts that NBA had complete authority to manage the business of NBAT; NBA set the premiums and received the premiums for NBAT; NBA received, adjusted, and settled NBAT claims; only NBA officers and employees had signature authority over NBAT bank accounts; the only representative of NBAT was paid by NBA; the original name of the trust was changed to NBAT to match NBA; and there was no

separation between the bookkeeping function of NBA and NBAT.

In support of his contention that NBA should be liquidated, Petitioner alleges that NBA and NBAT failed to observe the formalities of any separate corporate existence and as such there is no distinction between NBA and NBAT. NBAT has been placed into liquidation, and NBA should not be allowed to escape liability for its actions through NBAT. Thus, NBA should be placed into liquidation with NBAT.

In response to Petitioner's allegations, Respondents state that there has been no opportunity for discovery with regard to the issue of single identity and therefore there may be issues of material fact. Respondents further allege that there is insufficient evidence to support Petitioner's claims; NBA did not have control over NBAT, but rather NBAT's trustees had ultimate control; and there is no proof that NBA was undercapitalized. Thus, summary judgment is premature.

The U.S. District Court for the Western District of Kentucky previously determined that NBA as administrator for NBAT was subject to regulation by state law. (See, National Business Ass'n v. Morgan, 770 F. Supp. 1169 (W. D. Ky. 1991.) In reaching its ruling the court found instructive the ruling in Lowen v. Tower Asset Management, Inc., 829 F.2d 1209 (2nd Cir. 1987) where in the Court of Appeals stated

> Parties may not use shell-game-like maneuvers to shift fiduciary obligation to one legal entity while channeling profits from self dealing to a separate legal entity under its control.

> The Supreme Court has 'consistently refused to give effect to the corporate form where it is interposed to defeat legislative policies.' . . . (citations omitted).

Thus, the U.S. District Court effectively determined that there was no distinction between NBA and NBAT for the application of Kentucky insurance laws.

NBA admits that it managed NBAT pursuant to an administration agreement and maintains that the agreement speaks for itself. The administration agreement provided that NBA had complete and exclusive authority to market NBAT coverage, to set the premiums for NBAT coverage, to collect premiums for NBAT coverage, to receive claims under NBAT coverage, to adjust claims under NBAT coverage, to settle claims under NBAT coverage, to execute documents in the name of NBAT, to receive service of legal process on behalf of NBAT as designated agent, and to otherwise transact the business of NBAT. The unrefuted record shows that NBA had sole control of management of NBAT. NBAT had no offices or operations other than those provided by NBA. NBAT had no employees or officers other than its Executive Director whose sole source of compensation for his activities as Executive Director of NBAT came from NBA under the terms of the administration agreement. Only officers or employees of NBA could sign checks on NBAT's bank accounts. Thus, NBAT acted through and as one with NBA.

The Court next moves to the issue of whether NBA should be placed into liquidation.

In accordance with the Agreement for Plan Supervisor dated August 1, 1987, NBA provided administrative and related services to NBAT. In particular, NBA had full responsibility for arranging for the payment of claims from funds available to NBAT either by issuing a check or draft upon NBAT's bank account; NBA had sole authority to establish the amount of contributions to be made to NBAT by plan participants in accordance with sound and accepted actuarial practice; and NBA had the authority to pay all expenses of operation of the plan from NBAT accounts. This is further evidenced by the signature cards for the NBAT bank account at Stock Yards Bank & Trust Co. which indicate that all persons having signature authority on the NBAT accounts were directors or employees of NBA. Thus, it is apparent that NBA controlled the flow of money into and out of NBAT accounts.

The additional "limited documentary materials" filed as exhibits to NBA's supplemental memorandum support the dominant role of NBA over NBAT as outlined in the Agreement of Plan Supervisor.

On May 2, 1990, NBA ceased doing business. Shortly thereafter, NBAT also ceased doing business. By admission of NBA's own auditors, NBAT made up approximately 90% of NBA's business. Although an audit of NBA was apparently never completed, the partial examination of NBA books and records by Ernst & Young indicated that there was no separation between the bookkeeping function of NBA and NBAT and that without the financial support of NBAT, NBA was not a going concern. NBA was financially dependent upon NBAT revenue and, when NBAT ran

out of money, NBA went out of business, dismissed it employees and sold its office furniture and equipment.

On June 20, 1991, this Court determined that NBAT is insolvent. Due to NBA's financial dependency on NBAT, it naturally follows that NBA is also insolvent.

Respondent argues that there has not been adequate time for discovery and that as NBA's records are in the possession of the Department of Labor, NBA is unable to present the necessary documentation to support its position. Thus, they argue that there may be issues of material fact and summary judgment is premature at this time.

The case of Steelvest, Inc. v. Scansteel Service Center, Ky., 807 S.W.2d 476 (1991) restated the position of Kentucky courts with respect to summary judgment. In ruling on the standards to be utilized with respect to summary judgment practice in Kentucky courts, the Steelvest Court chose to follow the standard for summary judgment as set forth in the benchmark case of Paintsville Hospital Co. v. Rose, Ky., 683 S.W.2d 255 (1985). Thus, a motion for summary judgment should only be granted

> when, as a matter of law, it appears that it would be impossible for the respondent to produce evidence at the trial warranting a judgment in his favor and against the movant. Steelvest, supra, at 483.

Further, while the record must be viewed in a light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in

his favor, a party opposing a properly supported summary judgment motion cannot defeat it without presenting at least some affirmative evidence showing that there is a genuine issue of material fact for trial. Steelvest, supra, at 480, 482.

The Kentucky Court of Appeals has held that it is not necessary for discovery to be completed in order to obtain a summary judgment, but rather than the opposing party had an opportunity to engage in discovery. Hartford Insurance Group v. Citizens Fidelity Bank & Trust Co., Ky.App. 579 S.W.2d 628, 630 (1979).

This action was initiated on July 27, 1990. Further, the motion for summary judgement was originally placed under submission on October 17, 1991. Due to the appeal of a related action, this Court delayed making a determination on this motion for summary judgment until this time. Respondents have had ample opportunity to complete discovery, had have offered no affirmative evidence showing a genuine issue of material fact.

The pleadings and the record show that there is no genuine issue as to any material fact and Petitioner is entitled to a judgment as a matter of law. Accordingly, pursuant to CR 50.03, Petitioner's Motion for Summary Judgment is hereby GRANTED.

Further, it is hereby determined that NBA and NBAT is a single identity; and it is ORDERED, pursuant to KRS Chapter 304.33 that NBA be placed into liquidation under the terms of the June 20, 1991, Order Directing Liquidation of National Business Association Trust.

This is a final and appealable order and there is no just cause for delay.

Done and effective this 9th day of May, 1995.

/s/
JUDGE, FRANKLIN CIRCUIT COURT

APPENDIX I

OLR Case Opening and Information Sheet — U.S. Department of Labor Office of Inspector General

☐ Initial Submission or ☒ Change (Check One)

Date 10/06/92

1. Case #
   90 – CLV – 001

2. Date Opened
   11/27/89

2. Date Reopened

3. Title (Or Lead Subject)
   National Business Association Trust (NBAT)

4. Status (Code):	Enter Date	Enter Date
C	Inactive --	Reactive --

5. Case Agent
   b7 C

6. List Subjects (Last, First, MI)
   GLOGOWER, Andrew
   b7C

7. Nature of Investigation (Enter Code)
   BP

8. O/C Related
Yes (No)

Group (Enter Code)
N/A

9. Industry (Enter code)
H

10. Union (Enter Code)
N/A

11. Joint Agencies (Enter Code)
None

12. Primary? (Enter Code)
N/A

13. List Violations
b5

14. Source (Check One)
***
☒ Other (Explain)
State of Georgia issued a Cease and Desist Order re NBAT

15. Synopsis (500 Character Limit)
Prosecution declined for a number of significant reasons. First, this does not appear to be the case where the subjects actively misled the trustees. b5

Second, while ultimately the trust failed, it had a history of success. The administrative fee charged by the administrators were likewise in conformity with industry standards. Finally, no evidence was developed of skimming or misappropriation of funds.

B7c

Approved by: _____

SAC/SSA

File: 1 - Case File 2- OLRHO
(1 - Case Tracking System)
See Reverse For Codes

[handwritten code unreadable in original]

[Supp. ER 53]

APPENDIX J

UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA

00-06179-PHX-RTB
ADV. 00-00681

[Dated March 3, 2003]

In re:	)
	)
ANDREW D. GLOGOWER CH. 7	)
	)
1) JANIE A. MILLER vs ANDREW D. GLOGOWER	)
	)
PLAINTIFF'S MOTION IN LIMINE TO PRECLUDE ANY EVIDENCE SUGGESTING THAT NBA & NBAT WERE SEPARATE LEGAL ENTITIES	)
	)
2) JANIE A. MILLER vs ANDREW D. GLOGOWER	)
	)
TRIAL	)

U.S. Bankruptcy Court
2929 N. Central Ave., 9th Floor
Phoenix, AZ 85012

March 3, 2003
9:11 a.m.

BEFORE THE HONORABLE
REDFIELD T. BAUM, Judge

APPEARANCES:

For Janie A. Miller/Plaintiff:

David R. Jordan
TITUS, BRUECKER & BERRY, P.C.
7373 N. Scottsdale Road
Suite B-252
Scottsdale, AZ 85253-3527

For Janie A. Miller:

Greg E. Mitchell
Jan De Beer
(Both by Video Conference)
FROST BROWN TODD, L.L.C.
2700 Lexington Financial Center
250 W. Main Street
Lexington, KY 40507-1749

A/V• •TRONICS, INC.
Professional Court Reporting
& Transcription
Phoenix, AZ

* * *

[p.16]

We then rebriefed the issue. At that point in time, the Judge's order -- if I recall -- stated that at that time you could not find in the record the trust agreement, and accordingly, you didn't feel that you had everything in front of you.

In light of the ruling of the NBA/NBAT being one and the same, those funds all came and went to Mr. Glogower from NBA/NBAT, and in accordance with --

THE COURT: Let me ask you this. Let me ask a question here.

MR. MITCHELL: Yes, sir.

THE COURT: Isn't the judgment out of the state of Kentucky as to the personal liability Mr. Glogower a preference judgment?

MR. MITCHELL: It is, Your Honor. But in accordance with In re Penick, the fact that Mr. Glogower took money, acting in a fiduciary capacity, in order to find a preference judgment under the Kentucky liquidation statute, Judge Graham had to find a number of elements. And that is, he took those monies at a time of which NBA/NBAT was insolvent. In accordance with In re Penick then, that judgment should be nondischargeable.

THE COURT: Well, I guess we're -- I may differ with you, and that view is that as I read Penick, one of the key elements for finding a nondischargeable judgment is that

[p.17]

the money was taken from a trust fund. And I don't recall that the preference judgment or the record indicated the source of the funds that were used to pay Mr. Glogower the payments that were made.

I think -- I assume -- and I have to be candid, I haven't looked in the last couple of days -- that there's no dispute about the payments being made. But under Penick, one element is that the -- and I'm going to quote the second element -- quote, "Relations create an express or implied trust that placed a specific risk in the hands of Penick."

And so it would depend on the source of the funds paid to NBAT or NBA that were in turn paid to Mr. Glogower. At least according to the agreements, he got -- NBA received, I think it was, 20 percent -- I don't know if it was all the funds that came on, but I'm going to refer to it that way. Of the funds that came in, 20 percent were to go to NBA to pay, in effect, their overhead and their operations. And so I would assume, at this point, that that's not a trust fund, that portion of it.

MR. MITCHELL: Your Honor, but with regard to your ruling on the collateral estoppel, Judge Graham's ruling with respect to the single identity addressed the issues with respect to the trust agreement and the plan supervisor agreement that were created in 1997 in the foundation of its ruling that it was a single identity.

* * *

APPENDIX K

UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA

00-06179-PHX-RTB
ADV. 00-00681

[Dated March 4, 2003]

In re:	)
	)
ANDREW D. GLOGOWER CH. 7	)
	)
JANIE A. MILLER vs ANDREW D. GLOGOWER	)
	)
TRIAL	)
	)

U.S. Bankruptcy Court
2929 N. Central Ave., 9th Floor
Phoenix, AZ 85012

March 4, 2003
1:42 p.m.

BEFORE THE HONORABLE
REDFIELD T. BAUM, Judge

APPEARANCES:

For Janie A. Miller/Plaintiff:

David R. Jordan
TITUS, BRUECKER & BERRY, P.C.
7373 N. Scottsdale Road
Suite B-252
Scottsdale, AZ 85253-3527

For Janie A. Miller:

Greg E. Mitchell
Jan De Beer
(Both by Video Conference)
FROST BROWN TODD, L.L.C.
2700 Lexington Financial Center
250 W. Main Street
Lexington, KY 40507-1749

For Debtor/Defendant:

James P. Kneller
LAW OFFICE OF
JAMES P. KNELLER, P.C.
7509 E. First Street
Scottsdale, AZ 85251

Proceedings recorded by electronic sound technician, Juanita Pierson-Williams; transcript produced by A/V Tronics, Inc.

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* * *

[p.31]

MR. KNELLER: -- the joint pretrial says what the joint pretrial says.

MR. JORDAN: May I respond, Your Honor?

THE COURT: Go ahead.

MR. JORDAN: The entire point of our case is that Mr. Glogower was making payments to himself while acting as -- in a fiduciary capacity. The judgment that we're talking about found that he was liable for these amounts. Now this court --

THE COURT: Let me ask you something. Are you going to put on evidence that he paid this money out of an express trust fund?

MR. JORDAN: The checks did not come out of NBAT's account.

THE COURT: Well, isn't that going to be problematic for the defalcation of the fiduciary capacity?

MR. JORDAN: I don't believe so at all, Your Honor.

THE COURT: Well, you know --

MR. JORDAN: And this is the reason --

THE COURT: -- Penick says you got show the -- an express trust.

MR. JORDAN: Your Honor, this is the whole reason I'm going into what I'm going into right now. I mean you're really addressing the whole reason this whole line of questioning is occurring. It is our intent to demonstrate

* * *

APPENDIX L

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 07-16188
San Francisco, CA

[Dated February 12, 2009]

In the Matter of:	)
ANDREW D. GLOGOWER,	)
	)
Debtor,	)
	)
SHARON P. CLARK, Liquidator of	)
National Business Association Trust	)
and National Benefit Administrators,	)
	)
Appellant,	)
	)
v.	)
	)
ANDREW D. GLOGOWER,	)
	)
Appellee.	)
	)

TRANSCRIPT OF APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA ROGER G. STRAND, DISTRICT JUDGE, PRESIDING

BEFORE: D.W. NELSON, W. FLETCHER AND R. TALLMAN, CIRCUIT JUDGES

APPEARANCES:

For the Appellant:

By: Greg E. Mitchell
FROST BROWN TODD LLC
250 W. Main St.
2700 Lexington Financial Center
Lexington, KY 40507-1749

For the Appellee:

By: Kathi M. Sandweiss
JABURG & WILK, P. C.
3200 N. Central Ave., Ste. 2000
Phoenix, AZ 85012

Transcription Service:

AVTranz
365 E. Coronado Rd., Ste. #100
Phoenix, AZ 85004-1525

Proceedings recorded by electronic sound recording, transcript produced by transcription services.

[p.2] February 12, 2009

MR. MITCHELL: Please the Court. Good morning, Your Honor. Name is Greg Mitchell. I'm here on behalf of the National Association Business Trust, the liquidator, which is a state court insolvency proceeding. This matter concerns § 523(a)(4), discharge proceeding. This is an appeal by us, the liquidator, with regard to the overturning of findings of facts and conclusions and order of a bankruptcy court in Arizona, finding that the debt in question was nondischargeable in the bankruptcy proceeding.

JUDGE TALLMAN: So your client is the Commissioner of Insurance for Kentucky, who has been appointed as the liquidator; is that correct?

MR. MITCHELL: Yes, sir. That's correct, Your Honor. It's a state court insurance liquidation proceeding under state court insurance insolvency matters. The commissioner in that capacity acts as the liquidator, as appointed by the statutory reference. It's a separate scheme outside of the bankruptcy code dealing specifically with insurers; and in this case even more so, which is how important this case is, is it's an unauthorized insurer.

JUDGE TALLMAN: Mr. Mitchell, if we can sort of get right to the heart of it here.

MR. MITCHELL: Yes, sir.

JUDGE TALLMAN: The Franklin County Circuit Court [p.3] made a factual finding that NBAT and NBA were one in the same entity.

MR. MITCHELL: Yes, sir.

JUDGE TALLMAN: I read that as being the alter ego, pierce the veil, whatever you want to call it. It's just one organization.

MR. MITCHELL: Yes, sir.

JUDGE TALLMAN: Is that right?

MR. MITCHELL: Yes, sir.

JUDGE TALLMAN: And then on top of that we have the fact that Mr. Glogower did not bother to comply with any of the insurance regulations of the State of Kentucky, so he wasn't even a legitimate insurance company when he opened for business?

MR. MITCHELL: That's correct.

JUDGE TALLMAN: Okay. So the question is what is the effect of that factual finding on United States Bankruptcy and District Courts in the District of Arizona. Do they have to give full faith and credit to that factual finding as to the issue of being one in the same for purposes of assessing fiduciary obligations under ERISA. Have I got this right?

MR. MITCHELL: Yes, sir, absolutely. We believe absolutely, because in this case -- and obviously it's very difficult in the context of unauthorized insurers, where they set up a third party administrator and then you have a trust

* * *

[p.19] later. It was made after these -- after the payment was made to the 20 percent trust, and certainly long after these bonus and loan payments were made out of the 20 percent trust. There's no evidence of misappropriation of the funds in the 80 percent. And without a plan administrator --

JUDGE TALLMAN: It's --

MS. SANDWEISS: -- without employees --

JUDGE TALLMAN: Counsel, it's not a misappropriation. Nobody's accusing Mr. Glogower of theft. He's accused of breach of his fiduciary duty. It's called a defalcation in the law. And that is not misappropriation or theft. It's simply an improper use of trust money to pay a non-claim use.

MS. SANDWEISS: That's right, but the trust -- the express trust has to exist before the wrongdoing. And I know Your Honor is saying that it did. The 80 percent/20 percent existed. The 20 percent was always Mr. Glogower's money. It was never trust money. And so what we're trying to do here, what the liquidator's trying to do and what the Court is talking about doing is imposing -- there's some sense in the air of there was wrongdoing, the plan failed, there wasn't enough money to pay the claims out of the 80 percent.

JUDGE TALLMAN: Well, that in part is a breach of the fiduciary duty, is it not, the failure to properly underwrite the insurance risk so that you collect sufficient premiums from the employers to see to it that all of the anticipated claims [p.20] will be paid? Mr. Glogower breached his fiduciary obligation in that regard as well, did he not?

MS. SANDWEISS: That's not the standard though under § 523. That may or may not be a standard of breach of fiduciary duty, and it may have been a breach under the unauthorized insurance laws. But remember, this is not a Kentucky state law case.

JUDGE TALLMAN: Well --

MS. SANDWEISS: We're just talking about the specific requirements under § 523. And so whether or not there was a breach as to whether Mr. Glogower should or should not have asked the claimants for more money to be paid in higher premiums, maybe he should have, but that's not an issue that was tried in this case.

JUDGE TALLMAN: But one of the things that he didn't do was he didn't tell the trustees of the ERISA plan that there was not enough money to pay the claims. And that's another breach of fiduciary duty, is it not?

MS. SANDWEISS: No. Your Honor, with all due respect, first of all, that issue was not preserved in the joint pretrial statement. And that's important, because there was not evidence in the record as to that. Mr. Glogower was questioned and the questioning was -- went something like isn't it true that you didn't notify the trustees, and Mr. Glogower responded no, that's not true.

* * *

APPENDIX M

Frost Brown Todd LLC
Attorneys

KENTUCKY · OHIO · INDIANA · TENNESSEE · WEST VIRGINIA

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VIA ELECTRONIC FILING

May 21, 2009

Molly C. Dwyer, Clerk of Court
Office of the Clerk
U.S. Court of Appeals for the Ninth Circuit
P.O. Box 193939
San Francisco, CA 94119-3939

Re: Sharon P. Clark, Appellant v. Glogower, Appellee United States Court of Appeals for the Ninth Circuit Case No. 07-16188

Dear Ms. Dwyer:

Pursuant to 9th Cir. R. 36-4, the Appellant, Sharon P. Clark, Commissioner of the Kentucky Department of Insurance, in her capacity as Liquidator of the National Business Association Trust/National Benefit Administrators (hereinafter the "Appellant"), hereby

respectfully requests that this Court's April 3, 2009 disposition in the above-referenced matter be re-designated as an opinion and subsequently published. See **Attachment A**. In support of her request, the Appellant states as follows:

On April 3, 2009, this Court entered a Memorandum in which it vacated the judgment of the District Court and remanded the case with instructions to reinstate the judgment of the Bankruptcy Court. In entering this ruling, the United States Court of Appeals for the Ninth Circuit ***made a number of critical holdings pertinent to states' power to regulate insolvency and liquidation and the 11 U.S.C. § 523(a)(4) dischargeability of debts incurred by an Employment Retirement Incomes Security Act ("ERISA") fiduciary***. In light of the paucity of available case law on this issue, especially as it relates to unauthorized insurance trusts, the Appellant strongly urges the publication of the Court's ruling in the above-referenced matter.

In its criteria for publication, this Court has stated that it will publish a written, reasoned disposition as an Opinion if it "[. . .][i]nvolves a legal or factual issue of unique interest or substantial public importance [. . .]." See 9th Cir. R. 36-2. The Appellant reiterates that the ruling in this matter does more than simply resolve a long-standing dischargeability case—as is evidenced by the National Association of Insurance Commissioner's ("NAIC") willingness to file an *amicus curiae* brief in support of the Appellant's position. Rather, the outcome of this case will impact the state-based system of insurer insolvency regulation—with particular relevance to the

accountability of insurance trust fiduciaries to their policyholders.

In the Memorandum in question, the Court reiterated its position that a fiduciary under ERISA is a fiduciary under 11 U.S.C. § 523(a)(4) and that a fiduciary cannot use administrative accounts or other legal fictions to obfuscate his legal duties and obligations. Although prior case law such as In re Hemmerter, 242 F.3d 11,86, 1190 (9th Cir. 2001), has held that an ERISA fiduciary is also an § 523(a)(4) fiduciary, ***this case is the first instance to which this principle has been applied to a fiduciary who committed defalcation through an administrative entity under his complete control and authority***.

If the District Court's prior ruling had been allowed to stand, it would have created a legal loophole to facilitate unauthorized insurance and/or the misuse of insurance funds. In effect, the District Court's decision allowed those fiduciaries with control of money paid to insurance trusts by policyholders (be such a trust authorized or unauthorized under existing law) to siphon off such funds for their own personal use. According to the District Court, such activity did not constitute defalcation as long as the insurance trust was structured in such a way as to place an intermediate step between the trust and the fiduciary.

In the matter at hand, the $757,282.70 in loan and bonus payments were made to the fiduciary from an unauthorized insurance trust's administrative entity. According to the District Court's reasoning, because the money went from the Trust to the administrator, and then to the fiduciary, the debts in question were dischargeable. In contrast, if the money had gone

directly from the Trust to the fiduciary, the debts in question would be non-dischargeable under 11 U.S.C. § 523(a)(4). This reasoning incentivises insurance trust fiduciaries to structure separate administrative entities (over which they have complete control and authority) into which they can methodically transfer trust funds (regardless of whether the trust can meet its insurance obligations to policyholders). Once the monies are transferred into such administrative entities, they are no longer considered trust funds and can be spent on a host of otherwise unauthorized activities (e.g., exorbitant bonus payments, unreasonable salaries, etc.). This glaring loophole could obstruct ongoing efforts to effectively regulate the insurance industry as it permits shell-game-like maneuvers—shifting fiduciary obligations to one legal entity while channeling profits from self-dealing to a separate legal entity under their control.

In arriving at the decision that the fiduciaries debts were dischargeable under 11 U.S.C. § 523(a)(4), the District Court completely ignored the Kentucky state court determination that, due to their complete and total interdependence, the trust and administrator *were a single entity as a matter of law*. In fact, the United States Bankruptcy Court for the District of Arizona, despite granting a motion in limine to exclude any evidence attempting to show that the trust and administrator were not one, wanted to hear testimony on whether the "administrative fee" paid to the administrator by the trust constituted trust fund money.

In contrast, this Court applied the doctrine of full faith and credit to the Kentucky state court's earlier determination that the trust and administrator were

one and the same entity. In so doing, the Court correctly noted that "[o]nce the corporate veil has been pierced, there is no legally relevant distinction between the funds used to pay NBA [the administrator] and the funds used to pay beneficiaries." The United States Court of Appeals for the Ninth Circuit's deference to the Kentucky state court on this issue (especially in light of the Bankruptcy and District Courts' refusal to invoke the Full Faith and Credit Doctrine) is of critical importance to the effective regulation of the insurance industry.

Under the current regulatory structure, state courts are provided with judicial oversight over that state's insurance code. Generally, state law directs actions pertinent to the regulation and enforcement of that state's insurance code to a specific court (or judicial body such as the Virginia state Corporation Commission) with advanced knowledge of the nuances of that specific state's insurance laws. Although the McCarran-Ferguson Act (as well as elements of the Gramm-Leach Bliley Act) has enabled the federal preemption of certain aspects of insurance regulation, state courts still play a central role in the regulatory oversight of the insurance industry. As recognized in this Court's ruling, in instances such as the matter at hand, federal courts should provide state court decisions pertinent to non-preempted aspects of insurance regulation with full faith and credit as called for under the United States Constitution. Such deference is even more appropriate where the state court has specific, detailed knowledge on the area of the law it is ruling upon.

The United States Court of Appeals for the Ninth Circuit's explicit provision of full faith and credit to the

Kentucky state court's ruling on the structure of the insurance trust and administrator in question is critical to the effective control of unauthorized insurance. If, as in the matter at hand, federal Bankruptcy and District Courts' continue to insist that unauthorized insurers are not collaterally estopped from re-litigating critical facts previously ruled upon in state court proceedings, then time-consuming and potentially confusing testimony will continue to hamper regulators' efforts to curb unauthorized insurance and hold fiduciaries accountable to their policyholders. As such, it is of the utmost importance that state court rulings on this issue are observed and given the weight they are constitutionally owed.

As you will note from a review of the record, the NAIC obtained leave of court to file an *amicus curiae* brief in this case.[1] In its motion for leave, the NAIC stated that its "[. . .] interest in this case arises from the regulatory responsibilities vested in its members to preside over insurer liquidation and insolvency." See NAIC February 4, 2008 Motion for Leave, a copy of which is attached hereto as **Attachment B**. In its Motion, the NAIC listed a number of reasons that this Court should entertain its arguments in support of the Appellant in this matter. Specifically, the NAIC argued that "[t]his Court's disposition addresses key rulings made by the Kentucky Circuit Court that were not given due deference in bankruptcy proceedings." Id. As noted by the NAIC, its "[m]embers are vitally

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[1] The NAIC is a Delaware non-profit corporation whose membership consists of the principal insurance regulatory officials in the fifty (50) States, the District of Columbia, and the territories.

interested in the deference shown to the states' power to regulate insolvency and liquidation, a power which is granted by the McCarran-Ferguson Act and the Bankruptcy Code." Id. In addition, the NAIC stated that this case "[. . .] also examines the enforceability of the Non-admitted Insurance Model Act and the threat posed by this case to effective state-based regulation of insurer insolvency." Id. Obviously, the NAIC believes that this matter "[i]nvolves a legal or factual issue of unique interest or substantial public importance [. . .]" mandating publication. See 9th Cir. R. 36-2. As such, it filed an *amicus curiae* brief "[. . .] to assist the court on these issues *from a national perspective and with an eye toward public policy*." Id. (emphasis added).

In close, the Appellant argues that the interest in the effective regulation of the insurance industry strongly urges the publication of an Opinion in this matter. At the current time, there is an absence of substantial legal precedent in the area of unauthorized insurance which results in a significant amount of speculative litigation and vitiates any potential deterrent effect on potential wrongdoers. Therefore, it is important for the effective regulation of the insurance industry—especially in the area of unauthorized insurance—that a strong body of case law with legal precedent be created.

Therefore, in order to further the pervasive public interest in the effective regulation of the insurance industry through the creation of a strong body of case law, the Plaintiff urges the Court to amend its Opinion and designate the above-captioned case as "To Be Published."

Very truly yours,

/s/Greg E. Mitchell

* * *

[Certificate of Service omitted in printing of this appendix]

APPENDIX N

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 07-16188
D.C. No. CV-04-01724-RGS
District of Arizona, Phoenix

[Filed May 26, 2009]

In the Matter of: ANDREW D. GLOGOWER, Debtor, SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators, Appellant, v. ANDREW D. GLOGOWER, Appellee.	)

Before: D.W. NELSON, W. FLETCHER and TALLMAN, Circuit Judges.

ORDER

Appellant's request for publication, filed May 21, 2009, is hereby DENIED.

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(3)

No. 09-174

Supreme Court, U.S.
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In The

Supreme Court of the United States

ANDREW D. GLOGOWER,

Petitioner,

v.

SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Should this Court review the Court of Appeals for the Ninth Circuit's holding that collateral estoppel principles and public policy reasons required full faith and credit be given to the Kentucky state court's judgment that the National Business Association, Inc. ("NBA") was part of the same legal entity as the National Business Association Trust ("NBAT"), an express trust, for purposes of determining whether a judgment against the debtor for taking improper transfers from NBA was non-dischargeable under 11 U.S.C. § 523(a)(4) as a debt "for fraud or defalcation while acting in a fiduciary capacity," where nothing in the Bankruptcy Code conflicts with or precludes the Kentucky court's determination as to what property was included in the *res* of the NBAT express trust?

2. Should this Court resolve a matter of first impression, whether a fiduciary under ERISA fulfills the requirements of a fiduciary under 11 U.S.C. § 523(a)(4)?

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OPINION BELOW

The decision of the Ninth Circuit Court of Appeals is not reported, but the unpublished memorandum disposition dated April 3, 2009 is available on Westlaw at 2009 WL 887959. The Order denying the Petition for Rehearing and the Petition for Rehearing En Banc dated May 11, 2009, and the decisions of the District Court and the Bankruptcy Court are not reported. Copies of all four decisions are reproduced in the Appendix. (See Petitioner's App. A).

STATEMENT OF JURISDICTION

The judgment of the U.S. Court of Appeals for the Ninth Circuit was entered on April 3, 2009. The Petitioner timely filed a Petition for Rehearing/Rehearing En Banc on April 15, 2009. The Petition for Rehearing was denied on May 11, 2009. Petitioner filed a Writ of Certiorari on August 7, 2009. Petitioner invokes the jurisdiction of the United States Supreme Court under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The McCarran-Ferguson Act, 15 U.S.C. § 1012, states, "[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. . . . No Act of Congress shall be construed to invalidate, impair, or supersede

any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." (App. A).

The United States Bankruptcy Code, 11 U.S.C. § 109 provides that a person will not be a debtor under Chapter 7 if they are "a domestic insurance company. . . ." (App. A).

The United States Bankruptcy Code, 11 U.S.C. § 727 provides, as to a debtor under Chapter 7, that, except in circumstances enumerated in that section and except as to certain categories of debts excepted from discharge under 11 U.S.C. § 523(a), "[t]he court shall grant the debtor a discharge." (Petitioner's App. E).

11 U.S.C. § 523(a)(4) excepts from dischargeability any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *Id.* (Petitioner's App. E).

Article I, Section 8, Clause 4 of the U.S. Constitution provides for the power of Congress: "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." *Id.* (Petitioner's App. E).

28 U.S.C. § 1738 sets forth the manner in which Congress declared that full faith and credit is to be given in stating that "[t]he . . . judicial proceedings of any court of any . . . State, Territory or Possession . . .

shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." (App. A).

29 U.S.C. § 1002(21)(a) of the Employment Retirement Income Security Act ("ERISA") holds that "a person is a fiduciary with respect to an ERISA plan if: (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, . . . or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." (App. A).

29 U.S.C. § 1104(a)(1) of ERISA provides that a controlling fiduciary " . . . shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries. . . ." (App. A).

KRS § 304.33-010(4)(g) of the Kentucky Insurers Rehabilitation and Liquidation Law expressly provide that " . . . proceedings in cases of insurer insolvency and delinquency shall be deemed an integral aspect of the business of insurance and are of vital public interest and concern." (App. A).

KRS § 304.11-030(3)(b) of the Kentucky Insurers Rehabilitation and Liquidation Law provides that "in event of failure of any such unauthorized insurer to pay any claim . . . , any person who assisted or in any manner aided directly or indirectly in the

procurement of such insurance contract shall be liable to the insured for the full amount of the claim. . . ." (App. A).

KRS § 304.33-140 of the Kentucky Insurers Rehabilitation and Liquidation Law sets forth the grounds upon which the Kentucky Commissioner of Insurance may seek the liquidation of an insurer, including " . . . that [she] has reasonable cause to believe that there has been . . . wrongful sequestration or diversion of the insurer's assets . . . that if established would endanger assets in an amount threatening the solvency of the insurer . . . ; . . . that the insurer is or is about to become insolvent . . . ; [and] that the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public. . . ." (App. A).

KRS § 304.33-190 of the Kentucky Insurers Rehabilitation and Liquidation Law provides that the Franklin Circuit Court " . . . shall have exclusive jurisdiction over all matters relating to the [insurer] liquidation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the liquidation as well as all interpretation and enforceability of all contracts of insurance to which the insurer is a party." (App. A).

KRS § 304.33-240 of the Kentucky Insurers Rehabilitation and Liquidation Law provides a Liquidator with express authority to " . . . prosecute any action which may exist in behalf of the creditors,

members, policyholders, or shareholders of the insurer against any officer of the insurer, or any other person. . . ." (App. A).

STATEMENT OF THE CASE

In 1987, the National Business Association Trust ("NBAT") was organized for the purpose of providing health insurance coverage to their employees. (E.R. 1).[1] At its peak, NBAT provided insurance coverage to employees in twenty-one (21) states.[2] (E.R. 12). Despite a significant presence within the Kentucky insurance industry, however, NBAT never requested nor received a certificate of authority from the Kentucky Department of Insurance to transact insurance business in the Commonwealth. As such, NBAT was operating as an unauthorized insurer in the Commonwealth. (E.R. 113).

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[1] "E.R." shall mean the Excerpts of Record Volume 1 and Volume 2 filed by the Liquidator of the National Business Association Trust/National Benefit Administrators with the United States Court of Appeals for the Ninth Circuit, January 25, 2008.

[2] In addition to Kentucky, NBAT conducted unauthorized insurance business in the following states: Alabama, Arkansas, Colorado, Florida, Georgia, Illinois, Indiana, Louisiana, Missouri, Mississippi, North Carolina, New Mexico, New York, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

As is a common practice in the creation of unauthorized insurers, at its inception in 1987, NBAT entered into an Administration Agreement with National Business Association, Inc. ("NBA"). (E.R. 13). Under the Administration Agreement, NBA was responsible for every aspect of NBAT's operations, including: marketing, underwriting, collection of premiums, claims adjustment, and claims settlement. (E.R. 120 at 122-23). In return, under the Administrative Agreement, NBAT agreed to pay NBA twenty percent (20%) of all "contributions" (i.e., premiums) to the trust as an "administrative fee." (E.R. 13 at 17).

As noted by the United States Bankruptcy Court, District of Arizona ("Bankruptcy Court"), "[t]he operations of NBAT were a financial disaster in every sense of the word." (E.R. 229 at 230). Instead of implementing the sound actuarial practices required by the Kentucky Insurance Code (including the establishment of sufficient reserves), NBA administered the Trust on a strictly cash flow basis, paying claims from new revenues. (E.R. 202-203). Accordingly, by May 1990, less than three (3) years following its creation, NBAT ceased doing business – resulting in *millions* of dollars in outstanding benefits claims and little recourse for its thousands of policyholders. (E.R. 229 at 231).

On July 27, 1990, the Kentucky Department of Insurance filed a petition in the Commonwealth of Kentucky, Franklin Circuit Court ("Franklin Circuit Court") seeking liquidation of NBAT and NBA. (E.R. 102). The action alleged that: (1) NBAT was operating

as an unauthorized insurer; (2) NBAT was or was about to become insolvent; and (3) assets were wrongfully diverted from NBAT to NBA. *Id.* On June 20, 1991, the Franklin Circuit Court held that NBAT was an unauthorized insurer doing business in Kentucky and consequently placed NBAT into liquidation. (E.R. 113). The Commissioner of the Kentucky Department of Insurance was named as the Liquidator ("Liquidator").

During the state court liquidation proceedings, the Liquidator sought liquidation of NBA as well as NBAT on the grounds that there was no legal distinction between NBA and NBAT. The Liquidator contended that NBA and NBAT failed to follow the formalities of separate corporate existence, such that there should be no legal distinction between the two. The Franklin Circuit Court granted the Liquidator summary judgment, and entered an order holding that NBA and NBAT were a single entity and placed NBA under liquidation pursuant to the June 20, 1991 liquidation order. (E.R. 120). Because NBAT and NBA have been found as a matter of law to be one entity, they will be referred to hereinafter as NBAT/NBA Express Trust.

On reviewing the insolvent insurer's financial information, the Liquidator concluded that NBA's former President and CEO, Andrew D. Glogower ("Glogower" and/or "Petitioner"), had failed to properly account for NBAT/NBA Express Trust funds (over which he had complete control and authority). Several transactions were found to be of particular

concern. Specifically, in June 1989, while acting as a director of the administrative component of the express trust, Glogower approved a resolution authorizing a Bonus Payment in the amount of $362,282.70 from NBA to himself. (E.R. 178 at 181). Additionally, in September, 1988, while acting as director of NBA, Glogower approved a resolution authorizing the execution of a promissory note in the amount of $495,297.30 from NBA to himself. *Id.* Loan Payments were made to Glogower in partial satisfaction of the promissory note on November 6, 1989, November 8, 1989, December 5, 1989, and April 26, 1989, in the total amount of $395,000.00. *Id.*

On March 10, 1992, the Liquidator filed a civil action in the Commonwealth of Kentucky, Franklin Circuit Court against the Petitioner, as well as other officers and directors of the NBAT/NBA Express Trust, and on February 10, 1998, filed an Amended Complaint. (E.R. 127). On August 31, 1999, the Franklin Circuit Court entered a judgment in favor of the Liquidator against Glogower. (E.R. 161). The Judgment, *inter alia*, held Glogower liable for $395,000.00 for the unauthorized Loan and Bonus Payments he had received. *Id.*

When the Liquidator attempted to collect on the aforementioned judgment, the Petitioner declared bankruptcy in Arizona. The Liquidator filed an action before the Bankruptcy Court to designate the Franklin Circuit Court's Judgment non-dischargeable in the bankruptcy proceeding pursuant under 11 U.S.C. § 523(a)(4), which provides an exception to

dischargeability for debts "for fraud or defalcation while acting in a fiduciary capacity. . . ." (E.R. 167).

On September 17, 2003, the Bankruptcy Court issued its decision, finding that the June 1989 Bonus Payment of $362,282.70 and the Loan Payments paid between November 1989 and April 1990, totaling $395,000.00 constituted defalcation, and therefore, were non-dischargeable under 11 U.S.C. § 523(a)(4). (E.R. 229). The Bankruptcy Court noted that "Glogower's actions were particularly egregious where NBAT/NBA was holding properly payable benefit checks due plan participants/employees because there were insufficient funds to allow such checks to be honored when presented." *Id.* at 232. The Bankruptcy Court, however, did not hold Glogower's liability for the unpaid claims non-dischargeable, concluding that KRS § 304.11-030(1)'s provisions regarding unauthorized insurers did not constitute an exception to dischargeability under 11 U.S.C. § 523. *Id.* at 233. Glogower then appealed the Bankruptcy Court's ruling to the United States District Court for the District of Arizona ("District Court").

On May 31, 2007, the District Court reversed the Bankruptcy Court's ruling and held that the $362,282.70 Bonus Payment and the Loan Payments of $395,000.00 (as well as the pre- and post-judgment thereon) were dischargeable under 11 U.S.C. § 523(a)(4). (E.R. 259). The District Court held that the application of 11 U.S.C. § 523(a)(4) depended on the existence of an express or technical trust with respect to the funds in question. Notwithstanding the

fact that NBAT was an express trust and the Kentucky state court had already held NBAT and NBA were one legal entity, the District Court concluded that with respect to the funds transferred from NBA, "the Liquidator failed to meet its burden of establishing the existence of an express trust, and the Bankruptcy Court therefore erred in denying the Debtor a discharge under § 523(a)(4) with respect to the Bonus and Loan Payments." *Id.* at 270. On June 28, 2007, the Liquidator filed a timely Notice of Appeal to have the Ninth Circuit Court of Appeals review the District Court's May 31, 2007 Order. (E.R. 274).

The Ninth Circuit Court of Appeals reversed the District Court. The court acknowledged that under circuit precedent, for 11 U.S.C. § 523(a)(4) to apply, "the fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 811 (9th Cir. Apr. 03, 2009) (quoting *In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996)). The court held that the requirement of an express trust as to the assets of NBA was satisfied because it owed full faith and credit to the Franklin Circuit Court's determination that NBAT and NBA were a single entity. *Id.* at 812. Additionally, the court held that the fact that Glogower was a fiduciary under ERISA fulfilled the requirements of a fiduciary duty for purposes of 11 U.S.C. § 523(a)(4). *Id.* at 811. Finally, the Ninth Circuit Court held the Loan Payments and Bonus

Payments did constitute a defalcation under 11 U.S.C. § 523(a)(4). *Id.* at 812.

ARGUMENT

The Petitioner miscasts the issue before this Court as whether an "express" or "technical" trust must be shown for 11 U.S.C. § 523(a)(4)'s dischargeability exception to apply. As the Petitioner somewhat grudgingly acknowledges, however, the Ninth Circuit did expressly state that for liability to be imposed under 11 U.S.C. § 523(a)(4), the liability must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing giving rise to the claim. *See* Petition at 10. Thus, the Ninth Circuit did apply the narrow view of § 523(a)(4) that the Petitioner advocates.

The actual issue raised by the Petition, therefore, concerns the Petitioner's objection to the Ninth Circuit's conclusions that it was required to give full faith and credit to the Franklin Circuit Court's determination that NBA and NBAT were a single entity, and that this determination satisfied the Ninth Circuit's express or technical trust requirement. The Petitioner incorrectly contends that in giving effect to this state-court determination, the Ninth Circuit improperly elevated state insurance law over federal bankruptcy law in violation of the Bankruptcy Uniformity and Supremacy Clauses of the United States Constitution. That is not the case.

Granting full faith and credit to the Franklin Circuit Court's determination that NBA and NBAT were one and the same legal entity does not in any way conflict with federal bankruptcy law. To the contrary, this Court's precedents require that federal bankruptcy courts recognize the collateral estoppel effect of state court determinations on issues relating to the elements of a non-dischargeability claim. *See Grogan v. Garner*, 498 U.S. 279 (1991). The Franklin Circuit Court's ruling was not inconsistent with federal bankruptcy law. Even under the narrow view of 11 U.S.C. § 523(a)(4) advocated by the Petitioner, federal law merely imposes the requirement that the funds in question be subject to an express or technical trust. Nothing in the Bankruptcy Code purports to preempt the application of state law concerning what assets are included in the *res* of an express or technical trust, or whether a legal entity claiming to be separate from an express trust has so utterly failed to adhere to corporate formalities that it may be deemed to be the same legal entity as the express trust.

The importance of giving full faith and credit to the Franklin Circuit Court's judgment is reinforced by the express federal policy recognizing the primacy of state regulation of the insurance industry where not specifically and expressly preempted, even in the context of bankruptcy proceedings. The McCarran-Ferguson Act provides that federal laws will not supersede state insurance law, unless the federal law "specifically relates to the business of insurance." 15

U.S.C. § 1012. Federal deference to state insurance regulation is also expressly recognized in the Bankruptcy Code, 11 U.S.C. § 109(b)(2), which states that a domestic insurance company may not be a debtor under Chapter 7. This federal policy weighs heavily in favor of granting deference to state court determinations concerning the validity of efforts by an insurer to circumvent insurance regulation and its fiduciary duties by sequestering assets from a state-regulated insurer into a purportedly separate legal entity.

In addition to reaffirming the need to give full faith and credit to state court determinations in non-dischargement proceedings, this case offers the Court an opportunity to affirm the Ninth Circuit's precedents holding that a debtor's status as a fiduciary under ERISA satisfies the fiduciary duty element of 11 U.S.C. § 523(a)(4). This is an issue of first impression for the Court, and a definitive ruling from this Court on the question would provide valuable guidance to the lower federal courts in applying § 523(a)(4). ERISA expressly provides that "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plant or exercises any authority or control respecting management or disposition of its assets. . . ." 29 U.S.C. § 1002(21)(A). This provision expresses an important federal policy imposing strict duties on persons such as Glogower to administer ERISA benefit plan funds in the best interest of the plan

beneficiaries. The Ninth Circuit has correctly determined that these duties are precisely the kind of duties that are intended to be non-dischargeable under § 523(a)(4). This Court should affirm that precedent.

I. THE NINTH CIRCUIT COURT OF APPEALS WAS REQUIRED TO GIVE FULL FAITH AND CREDIT TO THE FRANKLIN CIRCUIT COURT'S 1995 ORDER, AND THEREFORE, HOLD THE BONUS PAYMENT AND LOAN PAYMENT NON-DISCHARGEABLE PURSUANT TO 11 U.S.C. § 523(A)(4).

The Ninth Circuit Court of Appeals' decision does not permit Kentucky state insurance regulations to override established federal bankruptcy law in violation of the bankruptcy uniformity clause of the U.S. Constitution. In order to find a debt non-dischargeable due to defalcation under 11 U.S.C. § 523(a)(4), the following elements must be proven: (1) the existence of a fiduciary relationship; (2) that this fiduciary relationship turned on the existence of an express or technical trust that placed a specific *res* in the hands of the debtor; and (3) that the debtor misappropriated or failed to account for those trust funds. *See R.E. America, Inc. v. Garver (In re Garver)*, 116 F.3d 176, 178-179 (6th Cir. 1997); *see also Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 390-391 (6th Cir. 2005); *In re Cantrell*, 329 F.3d 1119, 1125 (9th Cir. 2003) (*quoting*

Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996) ("The fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt."). In the matter at hand, the Ninth Circuit stated it owed full faith and credit to the Franklin Circuit Court's factual determination that NBAT and NBA were one and the same entity, and therefore, held the Liquidator had satisfied its burden of establishing an express trust. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009). The Petitioner does not question that NBAT itself was an express or technical trust.

The Ninth Circuit's decision reflects the proper application of principles of full faith and credit and collateral estoppel in bankruptcy proceedings. Indeed, Petitioner himself concedes that "it is generally true that a judgment by a court of competent jurisdiction bears a presumption of regularity and is not thereafter subject to collateral attack," provided that the state judgment does not "conflict[ ] with federal bankruptcy law." *See* Petition at 30. There is no conflict between the Kentucky state court judgment and federal bankruptcy law. The state court determined that there was no legally valid separation between the funds of NBA and those of NBAT, which were indisputably impressed with an express or technical trust. Petitioner identifies no federal law that would contradict this determination. The Franklin Circuit Court's judgment did not purport to alter the elements required to prove non-dischargeability under

11 U.S.C. § 523(a)(4). It merely conclusively determined one element of the test prescribed by federal law (as interpreted by the Ninth Circuit) – i.e., the existence of an express or technical trust with respect to the funds in question.

The Petitioner would have the Court hold that the bankruptcy uniformity clause of the U.S. Constitution precludes federal bankruptcy courts from giving any weight to state-court determinations on factual or legal issues relevant to non-dischargeability claims, whether or not those determinations are consistent with federal law. Such a rule is inconsistent with this Court's precedents and with the strong federal policy of deferring to the states on matters of insurance regulation. This Court should decline the Petitioner's invitation and instead use this case as an opportunity to reaffirm the importance of giving comity to state courts in federal bankruptcy proceedings, particularly in the sphere of insurance regulation.

A. Collateral Estoppel Principles Apply in Discharge Exception Proceedings.

The Kentucky Insurers Rehabilitation and Liquidation Law, KRS Chapter 304.33, unequivocally provides the Liquidator with specific statutory authority to exercise and enforce the remedies of creditors, members, policyholders, or shareholders of an insolvent insurer and to protect the interests of the general public. KRS § 304.33-010. In the state

court case, the Commissioner of Insurance sought to liquidate NBAT and sought to have NBA and NBAT declared one entity so that she could also liquidate NBA. In its May 10, 1995 Order, the Franklin Circuit Court found that NBA and NBAT were one entity based on NBA and NBAT's failure to observe any formalities of separate corporate existences:

> The administration agreement provided that NBA had complete and exclusive authority to market NBAT coverage, to set the premiums for NBAT coverage, to collect premiums for NBAT coverage, to receive claims under NBAT coverage, to adjust claims under NBAT coverage, to settle claims under NBAT coverage, to execute documents in the name of NBAT, to receive service of legal process on behalf of NBAT as designated agent, and to otherwise transact the business of NBAT. The unrefuted record shows that NBA had sole control of management of NBAT. NBAT had no offices or operations other than those provided by NBA. NBAT had no employees or officers other than its Executive Director whose sole source of compensation for his activities as Executive Director of NBAT came from NBA under the terms of the administration agreement. Only officers or employees of NBA could sign checks on NBAT's bank accounts. Thus, NBAT acted through and as one with NBA.

(E.R. 120 at 122-23). Thus, the state court placed NBA into liquidation under the terms of its earlier

order directing the liquidation of NBAT as an insolvent, unauthorized insurer. *Id.* at 125.

Applying the law of issue preclusion or collateral estoppel – applicable in dischargeability proceedings – the Ninth Circuit held as a matter of law that NBAT and NBA were one entity, and therefore, as a matter of law, there was an express trust. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009). The Full Faith and Credit Clause of the United States Constitution provides that states must give full faith and credit to the judicial proceedings of other states. U.S. CONST. ART. IV, § 1. Congress sets forth the manner in which such full faith and credit is to be given in 28 U.S.C. § 1738, declaring that "[t]he . . . judicial proceedings of any court of any . . . State, Territory or Possession . . . shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."

The Supreme Court has followed this command when the issue has arisen before it, explaining that:

> [T]hough the federal courts may look to the common law or to the policies supporting res judicata and collateral estoppel in assessing the preclusive effect of decisions of other federal courts, Congress has specifically required all federal courts to give preclusive effect to state-court judgments whenever the

> courts of the State from which the judgments emerged would do so.

Allen v. McCurry, 449 U.S. 90, 96 (1980). *See also Kremer v. Chem. Constr. Corp.*, 456 U.S. 461 (1982); *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518 (1986); *Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75 (1984). As made clear by the Supreme Court, "res judicata and collateral estoppel not only reduce unnecessary litigation and foster reliance on adjudication, but also promote the comity between state and federal courts that has been recognized as a bulwark of the federal system." *Allen v. McCurry*, 449 U.S. at 95-96.

Bankruptcy dischargeability proceedings are not exempted from the application of collateral estoppel principles. *See Grogan v. Garner*, 498 U.S. 279. Recognizing the preclusive effect of a state court determination on one or more elements of a non-dischargeability claim, therefore, does not elevate state law over federal bankruptcy law. *Id.* In *Grogan*, creditors who had obtained a money judgment in state court on the grounds that the debtor had defrauded them, sought to have the debt ruled non-dischargeable after the debtor filed bankruptcy. The bankruptcy court ruled that, as all of the elements required to establish actual fraud under 11 U.S.C. § 523 had been proved in state court, the doctrine of collateral estoppel required a holding that the debt was not dischargeable. This Court affirmed the bankruptcy court's application of collateral estoppel, stating "[o]ur prior cases have suggested, but have not

formally held, that the principles of collateral estoppel apply in bankruptcy proceedings under the current Bankruptcy Act. . . . We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)." *Id.* at 284 n.11. The Court held the standard of proof to apply to the discharge exceptions of § 523 is the preponderance of the evidence standard. *Id.* at 291. Thus, if a creditor has already proved an element of non-dischargeability in state court in his or her state claim, then collateral estoppel will apply to prevent the debtor from relitigating that element in the dischargeability proceedings. *Id.* at 284.

B. Kentucky Collateral Estoppel Law Dictates that the Franklin Circuit Court's May 1995 Order be Given Preclusive Effect.

The Ninth Circuit Court of Appeals was compelled to give collateral estoppel effect to the May 1995 Franklin Circuit Court Order to the same extent that the Kentucky courts would have done so. *Allen*, 449 U.S. at 96; *Grogan*, 498 U.S. at 284 n.11. Under the applicable Kentucky law of collateral estoppel, the order would have had preclusive effect.

In Kentucky, the elements required for issue preclusion are: (i) identity of issues; (ii) actual litigation of the issue in the first case; (iii) a decision on the issue in the first case; and (iv) the necessity of the decision on the issue in the first case on the court's

judgment. *Yeoman v. Commonwealth*, 983 S.W.2d 459, 465 (Ky. 1998). *See also Sedley v. City of West Buechel*, 461 S.W.2d 556 (Ky. 1971) (adopting concept of issue preclusion). The rule that issues that have already been litigated cannot be the subject matter of a later action "is not only salutary, but necessary to the speedy and efficient administration of justice." *Yeoman*, 983 S.W.2d at 465.

All of the requirements for the application of collateral estoppel under Kentucky law are met by the May 1995 Order of the Franklin Circuit Court. First, the issue in the state court proceeding, whether NBA was an entity separate from the trust, was identical to the issue in the bankruptcy dischargeability proceeding. Second and third, there was actual litigation of the single entity issue in the Franklin Circuit Court and a final decision on the merits. The issue was briefed extensively by the parties and was ripe for a decision. (E.R. 120). The Franklin Circuit Court entered its order granting summary judgment to the then-Commissioner of the Kentucky Department of Insurance, acting in her capacity as Liquidator, on May 10, 1995. Moreover, it is uncontested that the May 10, 1995 Order was a final decision on the merits.

Finally, the issue of whether NBAT and NBA were one and the same entity was necessary to the state court's judgment. The Commissioner brought her original Complaint under KRS § 304.33-190, which allows her to petition the court for an order directing her to liquidate a domestic insurer on any

ground specified in KRS § 304.33-140 "whenever [s]he believes that attempts to rehabilitate the insurer would substantially increase the risk of loss to its creditors, its policyholders or the public, or would be futile, or that rehabilitators would serve no useful purpose." The grounds in KRS § 304.33-140 upon which the Commissioner sought liquidation were:

> (b) That [she] has reasonable cause to believe that there has been . . . wrongful sequestration or diversion of the insurer's assets . . . that if established would endanger assets in an amount threatening the solvency of the insurer[;]
>
> (d) That the insurer is or is about to become insolvent[; and]
>
> (f) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public.

A plain reading of the statutes shows that it was necessary for the court to find that NBAT and NBA were one and the same – an unauthorized insurer – for the Commissioner to have the authority to liquidate NBA with NBAT. Otherwise, pursuant to KRS §§ 304.33-140 and 304.33-190, she would have only had the authority to liquidate NBAT. After deciding that NBAT and NBA were, in fact, one entity, the Franklin Circuit Court granted summary judgment to the Commissioner and ordered, "pursuant to KRS Chapter 304.33 that NBA be placed into liquidation under

the terms of the June 20, 1991 Order Directing Liquidation of National Business Association Trust." (E.R. 120 at 125).

C. Express Federal Policy of Deference to State Insurance Regulation Requires that Full Faith and Credit be Given to the Franklin Circuit Court's May 1995 Order.

In addition to the generally applicable law of preclusion and full faith and credit discussed above, the specific and express federal policy of deferring to the states in the sphere of insurance regulation provides further reason to give preclusive effect to the decisions of state courts in insurance liquidation matters. The McCarran-Ferguson Act provides that states may create laws regulating the insurance business. The Act creates a presumption against federal preemption of state insurance laws, providing that federal laws will not supersede state insurance law unless the federal law "specifically relates to the business of insurance." 15 U.S.C. § 1012.

The Bankruptcy Code, 11 U.S.C. § 109(b)(2), moreover, states that a domestic insurance company may not be a debtor under Chapter 7. Therefore, federal bankruptcy law does not supersede Kentucky insurance regulations. Rather, federal bankruptcy law, by excluding insurers from the purview of the Bankruptcy Code, specifically embraces a policy of deferring to the states in the handling of insurance

liquidation matters. Thus, the fact that the Franklin Circuit Court's determination that NBAT and NBA were a single legal entity was made in the context of insurance liquidation proceedings, and related specifically to the determination of what assets were available in liquidation for the protection of policyholders, weighs particularly heavily in favor of the Ninth Circuit's decision to give that judgment full faith and credit.

Taken together, the McCarran-Ferguson Act and the insurance company exclusion from the Bankruptcy Code embody a strong federal policy of deferring to state regulation of the insurance industry. *Wolfson v. Mut. Benefit Life Ins. Co.*, 51 F.3d 141, 147 (8th Cir. 1995). Indeed, this federal policy:

> as reflected in the McCarran-Ferguson Act and the express exclusion of insurance companies from the federal Bankruptcy Code . . . symbolize[s] the public interest in having the States continue to serve their traditional role as the preeminent regulators of insurance in our federal system and indicates the special status of insurance in the realm of state sovereignty.

Munich Am. Reinsurance Co. v. Crawford, 141 F.3d 585, 595 (5th Cir. 1998).

KRS § 304.33-190 gives the Franklin Circuit Court regulatory authority over all insurance liquidation disputes. This ensures that a court with advanced knowledge of the nuances and intricacies of

the state insurance industry will make all liquidation decisions. Because the Franklin Circuit Court has the greatest knowledge of the industry in Kentucky, its ruling, that, as a matter of law, NBAT and NBA were one entity, should have been and was honored by the Ninth Circuit Court of Appeals.

Indeed, if the Ninth Circuit had not given full faith and credit to the Franklin Circuit Court's determination that NBAT and NBA were one entity, yet another loophole would exist to facilitate unauthorized insurance. Under current Kentucky law, the principals of an unauthorized insurer are directly liable for the insurer's unpaid claims and losses. *See* KRS § 304.11-030(3)(b). If federal bankruptcy courts do not respect state court judgments concerning the validity of entity arrangements like that between NBAT and NBA, those with control of the funds paid to unauthorized insurance companies would be free to siphon off as much as they wish so long as their company is structured in such a way as to place an intermediate step between the trust and themselves. The deterrent effect of KRS § 304.11-030(3)(b), creating liability for those who facilitate unauthorized insurance activities, would be completely vitiated. Moreover, it would further obstruct regulators' ongoing efforts to effectively regulate the insurance industry and would essentially permit "laundering" of funds, in which trustees shift fiduciary obligations to one legal entity while channeling profits from self-dealing to a separate legal entity under the control of the individual channeling the funds. *Nat'l Bus. Ass'n*

Trust v. Morgan, 770 F. Supp. 1169, 1177 (W.D. Ky. 1991). In essence, a decision to disregard the Franklin Circuit Court's holding of one entity, would provide a "road map" for future unauthorized insurers wishing to escape liability for their misdeeds. A fiduciary could continue to market an insurance trust he knows to be insolvent and to accept new policyholders (even though the trust cannot pay the claims of existing policyholders), by simply funneling "administrative fees" into a separate account – at the expense of the very policyholders to whom he owes his fiduciary duty – and will as a result be rewarded by the discharge of the debt he should be adjudged to owe when his house of cards finally collapses.

D. As NBAT/NBA was an Express Trust as a Matter of Law, the Petitioner's Liability to the Liquidator for the Bonus Payment and Loan Payment is Non-Dischargeable Pursuant to 11 U.S.C. § 523(a)(4).

The Ninth Circuit after giving full faith and credit to the Franklin Circuit Court's holding that NBAT and NBA as one entity fulfilled the requirement for an express trust, held the remaining two elements for non-dischargeability under 11 U.S.C. § 523(a)(4): (1) Petitioner was a fiduciary of the express trust and (2) Petitioner misappropriated or failed to account for the trust funds; were also satisfied. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009).

1. The Petitioner Acted In A Fiduciary Capacity For The NBAT/NBA Express Trust.

While 11 U.S.C. § 523(a)(4) discharges a debt for fraud or defalcation while acting in a fiduciary capacity, the Ninth Circuit has held that a broad, general definition of fiduciary – a relationship involving confidence, trust, and good faith – is inapplicable in the dischargeability context. *See Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986). Rather, the Ninth Circuit has held the term "fiduciary" under 11 U.S.C. § 523(a)(4) only applies to express and technical trusts. *See In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996), *In re Johnson*, 691 F.2d 249, 251 (6th Cir. 1982). Accordingly, as its President and CEO, Glogower acted in a 11 U.S.C. § 523(a)(4) fiduciary capacity for the NBAT/NBA Express Trust over which he had general control and authority. (*See* E.R. 229; *see also* E.R. 1; E.R. 21 at 22; E.R. 25). Moreover, the Petitioner admitted to the Bankruptcy Court that as CEO and President he had complete authority over the plan administrator component of the NBAT/NBA Express Trust. (E.R. 195). Consequently, the Ninth Circuit upheld the Bankruptcy Court's determination that Petitioner was a fiduciary for purposes of 11 U.S.C. § 523(a)(4) and ERISA. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009).

2. The Petitioner Breached His Fiduciary Duties Through His Failure To Properly Account For NBAT/NBA Funds.

As the President and CEO, Glogower had complete control and authority over the assets of the NBAT/NBA Express Trust. (E.R. 21 at 22). At a time when Glogower was aware that the NBAT/NBA Express Trust was insolvent by millions of dollars and that insureds' claims checks were being held, he continued to make payments to himself, continued to collect premium payments from insureds, and oversaw the continued marketing of the NBAT/NBA Express Trust to unsuspecting customers. Above and beyond these actions, the Petitioner continued to make payments from NBAT to the plan administrator (from which Glogower misappropriated funds for his own personal use).[3] When referring to Glogower's receipt of the unauthorized Loan and Bonus Payments, the Bankruptcy Court explicitly noted that:

> Glogower's actions were particularly egregious where NBA/NBAT was holding properly payable benefit checks due plan participants/employees because there were insufficient funds to allow such checks to be honored when presented. In perhaps the ultimate

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[3] In fact, the Debtor demonstrated his attitude of entitlement to use NBAT/NBA Express Trust funds as his own when he admitted at trial that his various corporate "loans" could: "have been for a mortgage payment. It could have been for washing the dog. It could have been for anything." (E.R. 225-26).

> defalcation in fiduciary capacity constituting an improper misappropriation of trust funds, Glogower decided to pay himself when he was fully aware that the entities (NBAT/NBA) he controlled could not pay the claims due the plan beneficiaries.

(E.R. 229 at 232).

Moreover, these payments were not secured through recognized corporate resolutions, but were instead fraudulently obtained to benefit the Petitioner at the expense of the NBAT/NBA Express Trust insureds. Additionally, the Petitioner breached his fiduciary duties by never informing policyholders of the NBAT/NBA Express Trust's insolvency or that claims checks were being held. In its March 24, 2004 Order, the Bankruptcy Court found that:

> Based upon all of the evidence before it, the court agrees that the defendant violated his fiduciary duty of disclosure when he failed to adequately inform the beneficiaries and their employers of the severe financial distress of the NBAT. The court has already concluded that the operations of NBAT "were a financial disaster in every sense of the word." For example, in April 1990, when operations ceased, NBAT released for payment claim checks totaling about $3.5 million, but had to hold claim checks totaling about $5.7 million because it lacked the funds to pay those legitimate claims.

Id. (E.R. 236).

Moreover, as an unauthorized insurer, the NBAT/NBA Express Trust did not comply with the various Kentucky statutory requirements designed to protect the interests of policyholders. (E.R. 113). The Petitioner, despite his fiduciary duty of care, never maintained the required level of reserves and consequently failed to safeguard the investment of the trust beneficiaries. Instead of notifying the NBAT trustees and beneficiaries of the financial distress of the Trust, the Petitioner continued to collect premium payments and direct the continued marketing of the Trust.

Therefore, the Ninth Circuit upheld the Bankruptcy Court's finding that the Petitioner acted in a fiduciary capacity for the NBAT/NBA Express Trust, and that Glogower's actions resulted in a direct loss to the NBAT/NBA Express Trust beneficiaries – monies that could have been utilized to pay policyholder claims that were instead siphoned to the plan administrator component of the Trust (from which the unauthorized Bonus and Loan Payments were secured by the Petitioner). Therefore, the last two elements of the test were satisfied for finding the debt non-dischargeable under 11 U.S.C. § 523(a)(4). *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009).

II. THE NINTH CIRCUIT CORRECTLY HELD THAT PETITIONER'S STATUS AS AN ERISA FIDUCIARY FULFILLED THE REQUIREMENTS OF A FIDUCIARY UNDER 11 U.S.C. § 523(A)(4).

Should it hear this case, this Court should take this matter as an opportunity to affirm the Ninth Circuit's precedents holding that a debtor's status as a fiduciary under ERISA satisfies the fiduciary duty element of 11 U.S.C. § 523(a)(4). This is an issue of first impression for the Court, and a definitive ruling from this Court on the question would provide valuable guidance to the lower federal courts in applying § 523(a)(4).

The Ninth Circuit affirmed the Bankruptcy Court's determination that Petitioner was an ERISA fiduciary, and therefore, a fiduciary under 11 U.S.C. § 523(a)(4). *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009). The Ninth Circuit based its holding on its own case of *In re Hemmeter*, which squarely addressed the question of whether ERISA fiduciaries also constitute fiduciaries under 11 U.S.C. § 523(a)(4). *In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001). In that case, the Ninth Circuit reiterated the "fiduciary" requirements outlined in 29 U.S.C. § 1002(21)(A) and held that "these [fiduciary] duties necessarily arise upon creation of an ERISA plan and predate the creation of any debt to the plan participant creditor." *Id.* Critically, the Court stated that "[t]he trust res is identified by the creation of the plan itself." *Id.* Accordingly, as ERISA imposes

obligations on the fiduciary prior to the alleged wrongdoing, the Court found ERISA satisfied the traditional requirements for a statutory fiduciary to qualify as a fiduciary under 11 U.S.C. § 523(a)(4). *Id.*, (citing *Morgan v. Musgrove (In re)*, 187 B.R. 808, 814 (Bankr. N.D. Ga. 1995)).

This Court should affirm the Ninth Circuit's stance. ERISA expressly provides that "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plant or exercises any authority or control respecting management or disposition of its assets. . . ." 29 U.S.C. § 1002(21)(A). This provision expresses an important federal policy imposing strict duties on persons such as Glogower to administer ERISA benefit plan funds in the best interest of the plan beneficiaries. As the Ninth Circuit has properly recognized, these are precisely the kind of duties that are intended to be non-dischargeable under § 523(a)(4).

In *Nat'l Bus. Assoc. Trust v. Morgan*, 770 F. Supp. 1169, 1171, 1175 (W.D. Ky. 1991), the Petitioner admitted NBAT was an ERISA plan. *Id.* The Petitioner admitted to the Bankruptcy Court that as CEO and President he had complete authority over the plan administrator component of the NBAT/NBA Express Trust. (E.R. 195).[4] Individuals are accorded fiduciary

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[4] Additionally, Mr. Dale Belt, the former Chief Financial Officer, testified before the Bankruptcy Court as the Appellee's

(Continued on following page)

status where they "personally and actively controlled and dominated a corporation involved in investing and managing plan funds." *Greenblatt v. Prescription Plan Services Corp.*, 783 F. Supp. 814, 821 (S.D.N.Y. 1992) (*quoting Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1220 (2nd Cir. 1987)). As President and CEO of the plan administrator component of the express trust, the Petitioner personally and actively controlled and dominated the investment and management of plan funds, and consequently stood in a fiduciary capacity to the NBAT/NBA Express Trust under ERISA.

The Petitioner was plainly on notice that he had special fiduciary duties with respect to the funds of NBAT. The Ninth Circuit correctly held that these fiduciary duties are the same as those intended to be protected by 11 U.S.C. § 523(a)(4). A clear ruling from this Court affirming that vitally important principle would advance the policy goals of both ERISA's fiduciary duty provisions and the fiduciary defalcation exception of § 523(a)(4).

CONCLUSION

One of the fundamental policies of bankruptcy law is to give a fresh start to the "honest but unfortunate

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complete authority and dominance over the plan administrator and confirmed that whenever Glogower requested funds, a check was cut. (E.R. 204).

debtor." *Grogan v. Garner*, 498 U.S. 279, at 286. In the matter at hand, however, the Petitioner is not "honest but unfortunate," but was an unauthorized health insurer, who through the creation of NBA's "administrative fee" attempted to escape his fiduciary duties to the policyholders. As policyholders' medical bills continued to pile up, Glogower held their checks, while simultaneously paying himself and hunting for more unsuspecting customers. Glogower violated his position of trust and clear fiduciary obligations, by continuing to enrich himself at the expense of the NBAT/NBA insureds. A reversal of the Ninth Circuit Court of Appeals' decision would serve as a blueprint for con artists to swindle innocent citizens seeking health insurance coverage. For the reasons stated above, Respondent respectfully requests this Court to reaffirm the principles of collateral estoppel and the Full Faith and Credit clause and their proper application in conjunction with bankruptcy law, and to resolve an issue of first impression, whether an ERISA fiduciary fulfills the requirements of a fiduciary under 11 U.S.C. § 523(a)(4).

Respectfully submitted,

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APPENDIX A

11 U.S.C. § 109: Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not –

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)

(A) a foreign insurance company, engaged in such business in the United States; or

(B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978 in the United States.

(C) An entity may be a debtor under chapter 9 of this title if and only if such entity –

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts, and

(5)

(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of

each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if –

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)

(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111 (a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)

(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)

(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that –

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to

obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

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15 U.S.C. § 1012

(a) State regulation

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) Federal regulation

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

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28 U.S.C. § 1738: State and Territorial statutes and judicial proceedings; full faith and credit

The Acts of the legislature of any State, Territory, or

Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

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29 U.S.C. § 1002(21)

(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.], such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this subchapter, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

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29 U.S.C. § 1104(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

KRS § 304.11-030: Prohibition of unauthorized insurance business; applicability of law; liability of person acting as agent; executive director's power to enjoin

(1) It shall be unlawful for any company to enter into a contract of insurance as an insurer or to transact insurance business in this state, as set forth in subsection (2) of this section without a certificate of authority from the executive director; provided, that this subsection shall not apply to:

(a) The lawful transaction of surplus lines insurance.

(b) The lawful transaction of reinsurance by insurers.

(c) Transactions in this state involving a policy lawfully solicited, written, and delivered outside of this state covering only subjects of insurance not resident, located, or expressly to be performed in this state at the time of issuance, and which transactions are subsequent to the issuance of such policy.

(d) Transactions involving contracts of insurance independently procured through negotiations occurring entirely outside of this state which are reported and on which premium tax is paid.

(e) Attorneys acting in the ordinary relation of attorney and client in the adjustment of claims or losses.

(f) Transactions in this state involving group life and group health or blanket health insurance or group annuities where the master policy of such groups was lawfully issued and delivered in a state in which the company was authorized to do an insurance business.

(g) Transactions in this state involving any policy of insurance issued prior to July 1, 1968.

(h) Insurance on vessels, craft or hulls, cargoes, marine builder's risk, marine protection and indemnity or other risk, including strikes and war risks commonly insured under ocean or wet marine forms of policy.

(2) Any of the following acts in this state effected by mail or otherwise is defined to be doing an insurance business in this state. The venue of an act committed by mail is at the point where the matter transmitted by mail is delivered and takes effect. Unless otherwise indicated, the term "insurer" as used in this section includes all corporations, associations, partnerships and individuals, engaged as principals in the business of insurance and also includes interinsurance exchanges and mutual benefit societies.

(a) The making of or proposing to make, as an insurer, an insurance contract.

(b) The making of or proposing to make, as guarantor or surety, any contract of guaranty or suretyship as a vocation and not merely incidental to

any other legitimate business or activity of the guarantor or surety.

(c) The taking or receiving of any application for insurance.

(d) The receiving or collection of any premiums, commissions, membership fees, assessments, dues or other consideration for any insurance or any part thereof.

(e) The issuance or delivery of contracts of insurance to residents of this state or to persons authorized to do business in this state.

(f) Directly or indirectly acting as an agent for, or otherwise representing or aiding on behalf of another, any person or insurer in the solicitation, negotiation, procurement or effectuation of insurance or renewals thereof or in the dissemination of information as to coverage or rates, or forwarding of applications, or delivery of policies or contracts, or inspection of risks, or fixing of rates or investigation or adjustment of claims or losses, or in the transaction of matters subsequent to effectuation of the contract and arising out of it, or in any other manner representing or assisting a person or insurer in the transaction of insurance with respect to subjects of insurance resident, located or to be performed in this state. The provisions of this subsection shall not operate to prohibit full-time salaried employees of a corporate insured from acting in the capacity of an insurance manager or buyer in placing insurance in behalf of such employer.

(g) The doing of any kind of insurance business specifically recognized as constituting the doing of an insurance business within the meaning of the statutes relating to insurance.

(h) The doing or proposing to do any insurance business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of this code.

(i) Any other transactions of business in this state by an insurer.

(3)

(a) The failure of a company transacting insurance business in Kentucky to obtain a certificate of authority shall not impair the validity of any act or contract of such company and shall not prevent such company from defending any action at law or suit in equity in any court of this state.

(b) In event of failure of any such unauthorized insurer to pay any claim or loss within the provisions of such insurance contract, any person who assisted or in any manner aided directly or indirectly in the procurement of such insurance contract shall be liable to the insured for the full amount of the claim or loss in the manner provided by the provisions of such insurance contract.

(4) Whenever the executive director believes, from evidence satisfactory to him, that any company is violating or about to violate the provisions of these sections, the executive director may, through the

Attorney General of this state, cause a complaint to be filed in the Circuit Court of Franklin County to enjoin and restrain such company from continuing such violation or engaging therein or doing any act in furtherance thereof. The court shall have jurisdiction of the proceeding and shall have the power to make and enter an order or judgment awarding such preliminary or final injunctive relief as in its judgment is proper.

KRS § 304.33-010: Title, construction, and purpose

(1) Short title. This subtitle may be cited as the "Insurers Rehabilitation and Liquidation Law."

(2) Construction. No limitation of powers. This subtitle shall not be interpreted to limit the powers granted the executive director by other provisions of the law.

(3) Liberal construction. This subtitle shall be liberally construed to effect the purpose stated in subsection (4) of this section.

(4) Purpose. The purpose of this subtitle is the protection of the interests of insureds, creditors, and the public generally, with minimum interference with the normal prerogative of proprietors, through:

(a) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures, neither unduly

harsh nor subject to the kind of publicity that would needlessly damage or destroy the insurer;

(b) Improved methods for rehabilitating insurers, by enlisting the advice and management expertise of the insurance industry;

(c) Enhanced efficiency and economy of liquidation, through the consolidation of matters relating to the liquidation under the supervision of a single court so as to avoid divergent rulings by a multiplicity of judicial tribunals and through clarification and specification of the law, to minimize legal uncertainty and litigation;

(d) Equitable apportionment of any unavoidable loss;

(e) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extension of the scope of personal jurisdiction over debtors of the insurer outside this state;

(f) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business; and

(g) Provision for a comprehensive scheme for the supervision, rehabilitation, and liquidation of insurance companies and those subject to this subtitle as part of the regulation of the business of insurance, insurance industry, and insurers in this state. Proceedings in cases of insurer insolvency and delinquency

shall be deemed an integral aspect of the business of insurance and are of vital public interest and concern.

(5) All persons who voluntarily transact business with an insurer which is subsequently the subject of a delinquency proceeding under this subtitle shall be conclusively presumed to have transacted business with the intent that the provisions of this subtitle would control if there is any delinquency proceeding in this state.

(6) If there is a delinquency proceeding under this subtitle, the provisions of this subtitle shall govern those proceedings, and all conflicting contractual provisions contained in any contract between the insurer which is subject to the delinquency proceeding and any third party shall be deemed subordinated to the provisions of this subtitle. However, notwithstanding the foregoing, in any delinquency proceeding commenced against an insurer after July 15, 1996, nothing in this subtitle shall be construed to subordinate or restrict the rights of parties to submit their disputes to arbitration pursuant to a contractual arbitration clause contained in a reinsurance agreement.

KRS § 304.33-140: Grounds for rehabilitation

(1) The executive director may apply by verified petition to the court for an order directing him to rehabilitate a domestic insurer or an alien insurer

domiciled in this state on any one (1) or more of the following grounds:

(a) Any ground on which he may apply for an order of liquidation under KRS 304.33-190, whenever he believes that the insurer may be successfully rehabilitated without substantial increase in the risk of loss to creditors of the insurer or to the public.

(b) That the executive director has reasonable cause to believe that there has been embezzlement from the insurer, wrongful sequestration or diversion of the insurer's assets, forgery or fraud affecting the insurer, or other illegal conduct in, by, or with respect to the insurer, that if established would endanger assets in an amount threatening the solvency of the insurer.

(c) That any one (1) of the following circumstances has occurred and the executive director has reasonable cause to believe that the insurer is insolvent or that assets are endangered in an amount threatening the solvency of the insurer:

1. That information coming into the executive director's possession has disclosed substantial and not adequately explained discrepancies between the insurer's records and the most recent annual report or other official company reports;

2. That the insurer has failed to remove any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, employee, or other person, if the person has been found by the executive director after notice and hearing to be

dishonest or untrustworthy in a way affecting the insurer's business;

3. That control of the insurer, whether by stock ownership or otherwise, and whether direct or indirect, is in one (1) or more persons found by the executive director after notice and hearing to be dishonest or untrustworthy;

4. That any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, employee, or other person, has refused to be examined under oath by the executive director concerning its affairs, whether in this state or elsewhere, and after reasonable notice of the fact the insurer has failed promptly and effectively to terminate the employment and status of the person and all his influence on management;

5. That the insurer has refused to submit its books, accounts, documents, or other records to the reasonable examination or inspection of the executive director or his authorized representative.

(d) That the insurer is or is about to become insolvent.

(e) That the insurer is engaging in a systematic practice of reaching settlements with and obtaining releases from policyholders or third-party claimants and then unreasonably delaying payment of or failing to pay the agreed upon settlements.

(f) That the insurer is in such condition that the further transaction of business would be hazardous,

financially or otherwise, to its policyholders, its creditors, or the public.

(g) That within the previous twelve (12) months the insurer has systematically attempted to compromise with its creditors on the ground that it is financially unable to pay its claims in full.

(h) That without first obtaining the written consent of the executive director, the insurer has transferred, or attempted to transfer, substantially its entire property or business, or has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person.

(i) That the insurer or its property has been or is the subject of an application for the appointment of a receiver, trustee, custodian, conservator, or sequestrator or similar fiduciary of the insurer or its property otherwise than as authorized under this subtitle, and that such appointment has been made or is imminent, and that such appointment might oust the courts of this state of jurisdiction or prejudice orderly delinquency proceedings under this subtitle.

(j) That within the previous year the insurer has willfully violated its charter or articles of incorporation or any insurance law or regulation of this state, or having become aware within the previous year of an unintentional violation has failed to take

all reasonable steps to remedy the situation resulting from the violation and to prevent future violations.

(k) That the directors of the insurer are deadlocked in the management of the insurer's affairs and that the members or shareholders are unable to break the deadlock and that irreparable injury to the insurer, its creditors or its policyholders is threatened by reason thereof.

(l) That the insurer has failed to file its annual report or other report within the time allowed by law, and after written demand by the executive director has failed to give an adequate explanation immediately.

(m) That two-thirds (⅔) of the board of directors, or the holders of a majority of the shares entitled to vote, or a majority of members or policyholders of an insurer subject to control by its members or policyholders, consent to rehabilitation under this subtitle.

(2) Upon the issuance of an order directing the executive director to rehabilitate a domestic insurer, the court shall have exclusive jurisdiction over all matters relating to the rehabilitation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the rehabilitation as well as all interpretation and enforceability of all contracts of insurance to which the insurer is a party.

KRS § 304.33-190: Grounds for liquidation

(1) The executive director may apply by petition to the Circuit Court for Franklin County or for the county in which the principal office of the insurer is located for an order directing him to liquidate a domestic insurer or an alien insurer domiciled in this state on any one (1) or more of the following grounds:

(a) Any ground on which he may apply for an order of rehabilitation under KRS 304.33-140, whenever he believes that attempts to rehabilitate the insurer would substantially increase the risk of loss to its creditors, its policyholders or the public, or would be futile, or that rehabilitators would serve no useful purpose;

(b) That the insurer has commenced, or within the previous year has attempted to commence, voluntary liquidation otherwise than under the insurance laws of this state;

(c) That the holders of two-thirds (⅔) of the shares entitled to vote, or two-thirds (⅔) of the members or policyholders entitled to vote in an insurer controlled by its members or policyholders, have consented to a petition.

(2) Upon the issuance of an order directing the executive director to liquidate a domestic insurer, the court shall have exclusive jurisdiction over all matters relating to the liquidation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the liquidation as well as

all interpretation and enforceability of all contracts of insurance to which the insurer is a party.

KRS § 304.33-240: Powers of liquidator

The liquidator shall report to the court monthly, or at other intervals specified by the court, on the progress of the liquidation in whatever detail the court orders. The liquidator may:

(1) Appoint a special deputy to act for him under this subtitle, and, subject to the court's approval, determine his compensation. The special deputy shall have all powers of the liquidator granted by this section. The special deputy shall serve at the pleasure of the liquidator.

(2) Appoint or engage employees and agents, legal counsel, actuaries, accountants, appraisers, consultants, and other personnel he deems necessary to assist in the liquidation.

(3) Fix the compensation of persons under subsection (2) of this section, subject to the control of the court.

(4) Defray all expenses of taking possession of, conserving, conducting, liquidating, disposing of or otherwise dealing with the business and property of the insurer. If the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the liquidator may advance the costs so incurred out of any available appropriation. Any

amounts so paid shall be deemed expense of administration and shall be repaid for the credit of the Office of Insurance out of the first available moneys of the insurer.

(5) Hold hearings, subpoena witnesses and compel their attendance, administer oaths, examine any person under oath, and compel any person to subscribe to his testimony after it has been correctly reduced to writing, and in connection therewith require the production of any books, papers, record, or other documents which he deems relevant to the inquiry.

(6) Collect all debts and moneys due and claims belonging to the insurer, wherever located, and for this purpose institute timely action in other jurisdictions to marshal the assets of the insurer; forestall garnishment and attachment proceedings against such debts; do such other acts as are necessary or expedient to collect, conserve or protect its assets or property, including sell, compound, compromise or assign for purposes of collection, subject to court approval and upon such terms and conditions as he deems best, any disputed claims; and pursue any creditor's remedies available to enforce his claims. In lieu of collecting funds representing unearned premium of a policyholder which are in the possession of the insurer's agent with respect to the kinds of direct insurance protected under KRS 304.36-030, the liquidator may authorize the use of such funds to replace the insurance coverage terminated pursuant to KRS 304.33-210, upon receipt from the agent of appropriate notice of such

replacement of the insurance coverage with an insurer within sixty (60) days after the date of the liquidation order.

(7) Audit the books and records of all agents of the insurer insofar as these records relate to the business activities of the insurer.

(8) Conduct public and private sales of the property of the insurer in a manner prescribed by the court.

(9) Use assets of the estate to transfer policy obligations to a solvent assuming insurer, if the transfer can be arranged without prejudice to applicable priorities under KRS 304.33-430.

(10) Acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon, or otherwise dispose of or deal with any property of the insurer at its market value or upon such terms and conditions as are fair and reasonable, except that no transaction involving property the market value of which exceeds ten thousand dollars ($10,000) shall be concluded without express permission of the court. He also may execute, acknowledge, and deliver any deeds, assignments, releases, and other instruments necessary or proper to effectuate any sale of property or other transaction in connection with the liquidation. In cases where real property sold by the liquidator is located other than in the county where the liquidation is pending, the liquidator shall cause to be filed with the county clerk for the county in which the property is located a certified copy of the order appointing him.

(11) Borrow money, subject to court approval, on the security of the insurer's assets or without security and execute and deliver all documents necessary to that transaction for the purpose of facilitating the liquidation.

(12) Enter into such contracts as are necessary to carry out the order to liquidate, and affirm or disavow any contracts to which the insurer is a party.

(13) Continue to prosecute and institute in the name of the insurer or in his own name any suits and other legal proceedings, in this state or elsewhere, and abandon the prosecution of claims he deems unprofitable to pursue further. If the insurer is dissolved under KRS 304.33-220, he may apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

(14) Prosecute any action which may exist in behalf of the creditors, members, policyholders, or shareholders of the insurer against any officer of the insurer, or any other person.

(15) Remove any records and property of the insurer to the offices of the executive director or to such other place as is convenient for the purposes of efficient and orderly execution of the liquidation.

(16) Deposit in one (1) or more banks in this state such sums as are required for meeting current administration expenses and dividend distributions.

(17) File any necessary documents for record in the office of any county clerk or record office in this state or elsewhere where property of the insurer is located.

(18) Assert all defenses available to the insurer as against third persons, including statutes of limitations, statutes of frauds, and the defense of usury. A waiver of any defense by the insurer after a petition for liquidation has been filed shall not bind the liquidator.

(19) Exercise and enforce all the rights, remedies and powers of any creditor, shareholder, policyholder, or member, including any power to avoid any transfer or lien that may be given by law and that is not included within KRS 304.33-290, inclusive.

(20) Intervene in any proceeding wherever instituted that might lead to the appointment of a receiver or trustee, and act as the receiver or trustee whenever the appointment is offered.

(21) Enter into agreements with any receiver or commissioner of any other state relating to the rehabilitation, liquidation, conservation, or dissolution of an insurer doing business in both states.

(22) Exercise all powers now held or hereafter conferred upon receivers by the laws of this state not inconsistent with this subtitle.

(23) The enumeration in this section of the powers and authority of the liquidator is not a limitation upon him, nor does it exclude his right to do such other acts not herein specifically enumerated or

otherwise provided for as are necessary or expedient for the accomplishment of or in aid of the purpose of liquidation.

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In The
Supreme Court of the United States

ANDREW D. GLOGOWER,
Petitioner,

v.

SHARON P. CLARK, LIQUIDATOR OF NATIONAL BUSINESS ASSOCIATION TRUST AND NATIONAL BENEFIT ADMINISTRATORS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Petitioner, Respondent, and Amicus Curiae agree that certiorari should be granted but otherwise disagree on virtually all aspects of this appeal. Respondent paints a picture of a "con artist" who "swindles innocent citizens seeking health insurance coverage" and who "create[s] an. . . administrative fee. . . to escape his fiduciary duties to the policyholders" (Opposition, p. 34). These assertions not only are directly controverted by the record, (Petition, Appendix I), but appear calculated to influence the ultimate outcome of these proceedings by inappropriately tying Petitioner to recent well-publicized instances of financial fraud. More to the point, these inflammatory statements fail to address the split among the Circuits in the proper interpretation and application of 11 U.S.C. § 523(a)(4).

Respondent and Amicus Curiae consistently overstate the significance of underlying State Court findings, unnecessarily arguing for deference to the Kentucky Court. Respondent and Amicus Curiae jump from the Kentucky State Court's finding that NBA and NBAT are one entity – a determination made solely in the context of consolidated administration under Kentucky state insurance law – to the conclusion that there is an express trust sufficient to satisfy 11 U.S.C. § 523(a)(4). But to make that leap is to apply the unduly broad view of fiduciary duty adopted by the Second, Fifth and Seventh Circuits, *see In re Hayes*, 183 F.3d 162, 167 (2nd Cir. 1999), *In re Davis*, 3 F.3d 113, 116 (5th Cir. 1993), *Marchiando v. State of Illinois*, 13 F.3d 1111 (7th Cir. 1994), while rejecting the stricter standard adopted by the Sixth, Ninth and Tenth Circuits, *see In re Garver*, 116 F.3d 176, 178 (6th

Cir. 1997), *In re Cantrell*, 329 F.3d 1119, 1126 (9th Cir. 2002), *In re Young*, 91 F.3d 1367 (10th Cir. 1996). The Petition thus squarely presents an issue requiring resolution of a split in authority among the Circuits.

The emphasis on the Kentucky state insurance regulations fails, moreover, to address the primacy of bankruptcy law over state regulatory law. The McCarran-Ferguson Act, relied on at length by Amicus Curiae, is a red herring. The Act does provide that a state insurance law will "preempt a conflicting federal law" (Amicus Brief, p. 10); 15 U.S.C. § 1012(b); but because the Act says nothing about discharge in bankruptcy, there is no inconsistency between the Bankruptcy Code and the Act and thus no issue of reverse preemption. The principles of federal primacy and uniformity mandate that dischargeability under 11 U.S.C. § 523(a)(4) be resolved solely by reference to federal bankruptcy law.

Petitioner urges this Court to disregard these prejudicial mischaracterizations and grant certiorari to (1) resolve the split among the Circuits regarding the nature of "defalcation in a fiduciary capacity" under 11 U.S.C. § 523(a)(4), (2) give effect to the fundamental principle of federal preemption of bankruptcy law, and (3) clarify and give continuing vitality to this Court's holding in *Chapman v. Forsyth*, 43 U.S. 202 (1844).

I. RESPONDENT'S BRIEF DEMONSTRATES AN IRRECONCILABLE SPLIT AMONG CIRCUITS, REQUIRING CORRECTIVE ACTION BY THIS COURT.

Respondent insists that because the Kentucky State Court found that NBA and NBAT were "one entity," it must follow that (1) the combined entity is an express trust and (2) any money paid from the combined entity was trust money. Any other interpretation, according to Respondent, fails to give "full faith and credit" to the Kentucky State Court Order. But the interpretation of 11 U.S.C. § 523(a)(4) urged by Respondent has been rejected in at least three Federal Circuits and cannot be reconciled with this Court's ruling in *Chapman*. Review is thus necessary to resolve a split among the Circuits and bring controlling law in line with this Court's prior rulings.

A. Under the Narrow View Adopted by this Court and the Sixth, Ninth and Tenth Circuits, Defalcation in a Fiduciary Capacity Within the Meaning of 11 U.S.C. § 523(a)(4) Requires an Express or Technical Trust That Pre-Exists the Act Creating the Debt.

More than 160 years ago, this Court held that denial of bankruptcy discharge for defalcation in a fiduciary capacity is permissible only where the debtor holds the money in a "technical trust." *Chapman,* 43 U.S. 202. Later, this Court confirmed that the limited scope of the § 523(a)(4) exception had been applied in the intervening years "with unbroken continuity." *Davis v. Aetna Acceptance Co.,* 293 U.S. 328, 333 (1934), citing *Neal v. Clark*, 95 U.S. 704 (1877); *Hennequin v. Clews*, 111 U.S. 676 (1884); *Noble v. Hammond,* 129 U.S. 65, 68 (1889); *Upshur v. Briscoe*, 138 U.S. 365 (1891). This Court further held that the debtor must have been a trustee before the wrong and without reference thereto. *Davis*, 293 U.S. at 333.

The Sixth, Ninth and Tenth Circuits clearly follow this Court's view, *Garver*, 116 F.3d at 178; *Cantrell*, 329 F.3d at 1126; *Young*, 91 F.3d at 1371 – 1372. For example, in *Cantrell*, the Ninth Circuit held that while corporate officers possess the fiduciary duties of an agent, they are not trustees with respect to corporate assets, because "although the debtor may have owed a general fiduciary duty as a corporate officer under state case law, no pre-existing or statutorily created trust existed at the time of the alleged wrongdoing [citation omitted]." 329 F.3d at 1127, see fn 5. These Circuits thus apply a two-prong test for defalcation under the Bankruptcy Code: (1) an express trust res, (2) that pre-existed the debt or wrongful act.

B. In Violation of this Court's Interpretation, the Second, Fifth and Seventh Circuits Define Fiduciary Duty in Terms of the Person Rather Than the Specific Debt.

The opposing view of "defalcation in a fiduciary capacity" is exemplified by the Second Circuit decision in *Hayes*, 183 F.3d 162. After the death of artist Andy Warhol, Attorney Edward Hayes was retained as counsel to the estate. Hayes later owed the Andy Warhol Foundation $1.35 million for overpayment of fees, and filed bankruptcy to discharge the obligation. The Foundation sought non-dischargeability under 11 U.S.C. § 523(a)(4). 183 F.3d at 165.

The bankruptcy court found that there was no "express or technical trust established between Debtor and the Foundation" and that Hayes was not "acting in a fiduciary capacity at the time he incurred his $1.35 million deficit to the Foundation." The district court

affirmed, holding that Hayes was not "a trustee of an 'express' or 'technical' trust." 183 F.3d at 165 -166.

The Second Circuit reversed, emphasizing "a difference in knowledge or power between fiduciary and principal." 183 F.3d at 167. The *Hayes* Court held that the restriction applied to the ***person*** rather than the ***particular debt,*** 183 F.3d at 167, noting that, while the attorney-client relationship does not typically involve a technical or express trust, the relationship "has long been understood to be a fiduciary relationship within the meaning of the defalcation exception." 183 F.3d at 168, citing *Marchiando,* 13 F.3d at 1115 ("[A] lawyer is deemed the fiduciary of his client [under § 523], even if he does not manage a fund entrusted to him by the client....").

C. The Overly-Broad View Espoused by the Second, Fifth and Seventh Circuits Leads to Anomalous Results.

As in *Hayes,* and implicitly following similar Fifth and Seventh Circuit authority, Respondent posits a fiduciary obligation applicable to Glogower as a ***person,*** rather than on the ***specific debt***. In so doing, Respondent demonstrates why and how the Circuit split is so insidious.

As President and CEO of the "one entity," Glogower acted in a "fiduciary capacity for the NBAT/NBA Express Trust over which he had general control and authority." (Opp. p. 27). Assuming this to be so, there is nevertheless no basis for § 523(a)(4) non-dischargeability, as Glogower's conduct did not violate any discernable provision of the trust. It is undisputed that the 20% Administrative Fee (from which

Glogower received payments) was properly segregated to pay expenses, such as rent, utilities, and salaries. (See App. F). Respondent blithely argues that it was a violation of the express trust for Glogower to pay himself from that fund. (Opp., p. 28). But this conclusion ignores the absence of any specific trust violation and flies in the face of this Court's holding in *Davis* that the trust relationship must exist independently of the alleged wrongful act.

To understand the fallacy in Respondent's reasoning, consider: At what point did the "express trust" require Glogower to stop paying himself from the 20% administrative fund? Was he entitled to draw his normal salary? Pay other employees' salaries? Was he permitted to pay rent? Utilities? The record provides no answers. More significantly, as there is nothing in any trust instrument addressing these issues, how could Glogower have known that the payments to himself were in breach of the terms of the trust? To characterize Glogower's conduct as defalcation in a fiduciary capacity is to create an undefined trust relationship retroactively and out of whole cloth.

Nor is the result sought by Respondent supportable by reference to ERISA. See 29 U.S.C.A. § 1001. Under ERISA, "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets." (Opp., p. 13, citing 29 U.S.C. § 1002(21)(A)). Applying a Second Circuit *Hayes*-type analysis, Respondent in effect argues that because Glogower as a *person* was an ERISA fiduciary, the specific debt is

irrelevant to the inquiry. But this analysis leaves unanswered the questions posed above. Assuming that Glogower was an ERISA fiduciary, the question remains what were his obligations regarding the use and disposition of the 20% administrative fund. To conclude that, because he was an ERISA fiduciary, he committed an act of defalcation by authorizing a payment to himself is to ignore the *Davis* requirement of a pre-existing trust relationship and impose liability in the absence of any ascertainable standard of performance.

Blyler v. Hemmeter, 242 F.3d 1186, 1190 (9th Cir. 2001), relied upon by Respondent, holds that an ERISA fiduciary qualifies as a fiduciary within the meaning of § 523(a)(4). (Opp., pp. 31 – 32). But under *Hemmeter,* as under all cases that follow this Court and the Sixth, Ninth and Tenth Circuit view, the essence of defalcation is "a failure to produce funds entrusted to a fiduciary." 242 F.3d at 1191. Thus, the merely holding that statutory ERISA fiduciaries qualify as fiduciaries under § 523(a)(4) "does not end our inquiry." 242 F.3d at 1190. ERISA satisfies the traditional requirements for a statutory fiduciary to qualify as a fiduciary under § 523(a)(4) because it "imposes obligations on the fiduciary ***prior*** to the alleged wrongdoing." 242 F.3d at 1190, emphasis added.

The Sixth, Ninth and Tenth Circuits, in applying § 523(a)(4), properly require a pre-existing obligation, coupled with express, enunciated, trust terms; this

necessarily involves a mutual intent to create a trust.[1] The underlying policy is one of "fair warning" as to what acts would be non-dischargeable. Glogower was aware, as to the 80% fund set aside for payment of claims, that the funds constituted a trust *res* and could not be used for any other purpose. But what standard of conduct applied to the 20% Administrative Fee? Respondent argues that Glogower "misappropriated funds for his own personal use" from the 20% fund, stating that Glogower "admitted at trial" that he could have used the Administrative Fee "for a mortgage payment [or] . . . for washing the dog." (Opp., p. 28, fn 3). But Glogower was absolutely correct. With respect to the 20% Administrative Fee, he was not "a trustee before the wrong and without reference thereto." *Davis*, 293 U.S. at 333. Because the proper uses of the 20% fund are not determinable by reference to any trust agreement or other definable standard, Glogower had no way of knowing he could not pay himself from the 20% fee until he did it. And, because the bonus and loan payments were made to Glogower in 1989 and 1990, and the "one entity" order was not entered until May 10, 1991, Respondent's theory necessarily requires an after-the-fact imposition of a trust on these funds.

Nor, in the absence of explicit trust terms, could an express trust have been imposed on all money of NBA/NBAT simply by virtue of Glogower's status as a fiduciary. The underlying trust agreement requires

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[1] The Sixth Circuit standard is helpful, by describing the requirements to establish the existence of an express or technical trust: (1) an intent to create a trust; (2) a trustee; (3) a trust res; and (4) a definite beneficiary. *In re Blaszak*, 397 F.3d 386, 391 - 392 (6th Cir. 2005).

that the 80% fund be used to pay claims, but contains no such requirement as to the 20% remainder, leading unalterably to the conclusion that the 20% Administrative Fee was not required to be set aside to pay claims. (Petition, App. F). Respondent's theory, following the Second, Fifth and Seventh Circuits' interpretation of "defalcation in a fiduciary capacity," relies on an after-the-fact rationalization to justify the imposition of a trust over the 20% fund. The better analysis, following the Sixth, Ninth and Tenth Circuits' approach, complies with this Court's requirement that there be a trust prior to and without reference to the alleged wrong, is consistent with the terms of the operative trust instrument, and satisfies basic principles of fair notice.

D. It is Necessary and Appropriate That this Court Grant Certiorari to Resolve The Split Among Circuits.

Because the Constitution requires uniformity among bankruptcy laws throughout the country, Art. 1, §8, Cl. 4, this Court should grant certiorari to resolve the irreconcilable split among the Circuit Courts. *AT & T Corp. v. Hulteen,* 129 S.Ct. 1962, 1968 (2009).

II. THE OPPOSITION BRIEFS EMPHASIZE EXALTATION OF KENTUCKY STATE INSURANCE REGULATIONS OVER FEDERAL BANKRUPTCY LAW, IN VIOLATION OF THE BANKRUPTCY CLAUSE OF THE U.S. CONSTITUTION.

The theme of briefs by both Respondent and Amicus Curiae is deference to state insurance

regulation. The Amicus Brief insists that this case "implicates the primacy of the states in regulating insurance insolvency," and argues that the McCarran-Ferguson Act results in "reverse preemption" of state insurance laws over federal laws. (Amicus Brief, pp. 3, 10). But this is a red herring; there is no inconsistency between the McCarran-Ferguson Act and the Bankruptcy Code and nothing in the Act that addresses discharge in bankruptcy.

The McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015, provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance ...." See 15 U.S.C. § 1012(b). The purpose of the Act is declared in 15 U.S.C. § 1011 as "continued regulation and taxation by the several States of the business of insurance is in the public interest." The law was enacted to ensure that the States would have the ability to tax and regulate the business of insurance. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 217-218 (1979).

The Amicus Brief argues that "the states have clear authority [under the Act] to regulate the business of insurance." (Amicus Brief, pp. 6 – 14). But the discharge provisions of the Bankruptcy Code do not offend such regulatory authority. The "fresh start" policy of the Bankruptcy Code, *Grogan v. Garner*, 498 U.S. 279, 286 (1991), transcends statutory and regulatory schemes; indeed, the purpose of discharge is to relieve a debtor of otherwise valid and enforceable debts. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 243-244 (1934). The expressed policy of the McCarran-Ferguson Act has nothing to do with whether a debt incurred under color of State insurance law is subject

to discharge under the Bankruptcy Code. In no realistic sense, therefore, do the discharge exception rules of 11 U.S.C. § 523 displace, pre-empt or take over the States' prerogatives regarding taxation and regulation of the insurance business.

Significantly, as to 11 U.S.C. § 523(a)(4) "there is no specific state law conflicting with federal bankruptcy law." (Amicus Brief, p. 9). Neither the McCarran-Ferguson Act nor Kentucky state insurance regulations addresses dischargeability under the Bankruptcy Code. Nor could there be a state law regulating dischargeability, because the right to a discharge is decided under federal law alone, *Matter of Armstrong*, 931 F.2d 1233 (8th Cir. 1991), and the issue of non-dischargeability is to be determined by the bankruptcy court, with reference to federal law. See *Brown v. Felsen*, 442 U.S. 127 (1979). Under the Bankruptcy Clause, moreover, the policies and fundamentals of the Bankruptcy Code override any state law and any underlying state court determination of liability in the first instance. See *Kalb v. Feuerstein*, 308 U.S. 433, 438-439 (1940).

The relevant inquiry, in this context, is thus not whether Glogower is liable under Kentucky state insurance law for the Bonus and Loan Payments; the question is whether an otherwise valid debt is subject to discharge under the Bankruptcy Code. Liability and dischargeability are two entirely different concepts; in every case of dischargeability there is an underlying debt to be discharged. Dischargeability is determined, without deference to the law of any State, by reference to appropriate provisions of the Bankruptcy Code as implemented by the Federal Courts. *Brown*, 442 U.S. at 136 – 137.

11 U.S.C. § 727 provides, in mandatory terms, that Chapter 7 debtors are entitled to a discharge, except for reasons set forth specifically in § 523. Given the overriding principle of federal preemption, Const., Art. 1, §8, Cl. 4, these statutory provisions necessarily preclude any action that would frustrate the right of a debtor to discharge solely by reference to state insurance regulations. There is nothing in Kentucky law, or in the McCarran-Ferguson Act, that would authorize or permit a state insurance department to overrule and rewrite Federal bankruptcy law. Such a result would violate the Bankruptcy Clause, which provides that the power of Congress to establish uniform bankruptcy laws is unrestricted and paramount. Art. I, §8, Cl. 4; *International Shoe v. Pinkus,* 278 U.S. 261 (1929).

CONCLUSION

It is therefore requested that this Court grant certiorari.

RESPECTFULLY SUBMITTED this 26th day of October, 2009.

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NO. (1)

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In The
Supreme Court of the United States

WAYNE-DALTON CORP.,

Petitioner,

v.

AMARR COMPANY,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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Questions Presented

The United States Court of Appeals for the Federal Circuit disposed of petitioner's first appeal with a one-word judgment of affirmance.

The Federal Circuit designated its one-word decision "nonprecedential," thereby frustrating the possibility of meaningful further review by that court because of its stated policy that "[a] petition for rehearing *en banc* is rarely appropriate if the appeal was the subject of a nonprecedential opinion by the panel of judges that heard it." Fed. Cir. R. 35, Practice Notes.

This action of the Federal Circuit deepens a conflict between the circuits, frustrates the purpose of the false advertising provision of the Lanham Act to protect the consumer, and gives rise to two questions of constitutional import:

1. In an action for false advertising brought under the Lanham Act, does the Seventh Amendment right to a jury trial permit a district court to rule on the nature of the accused statement (i.e., false v. misleading)* as a matter of

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* The Sixth Circuit recognizes three categories of factual statements as actionable under the Lanham Act: (1) "literally false" statements, (2) "literally true, yet deceptive" statements, and (3) statements that are "too ambiguous to support a finding of literal falsity." *American Council of Certified Podiatric Physicians and Surgeons v. American Board of Podiatric Surgery, Inc.*, 185 F.3d 606, 614 (6th Cir. 1999). The proof required to establish a violation for statements that fall in either the second or third categories is the same. *Id.*

law, thereby taking that fact-intensive inquiry away from the jury, when:

a. determinations of the meaning, and not just the truthfulness of advertising statements, were issues tried to a jury at common law; and

b. Petitioner Wayne Dalton Corp. presented the district court with substantial evidence from which a jury could find that Respondent Amarr Company's advertisements were false?

2. Does the Federal Circuit's practice of disposing of appeals with one-word judgments of affirmance and designating them as "non-precedential" violate one or more of the following articles or amendments of the Constitution: Article III, Amendment I, and Amendment V?

Rule 29.6 Statement

The caption contains the names of all parties that appeared in the Federal Circuit. Petitioner Wayne-Dalton Corp. has no parent corporations, and no publicly held company owns 10% or more of Wayne-Dalton Corp.'s stock.

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Opinions Below

The opinion of the Federal Circuit was issued on March 31, 2009, and was not selected for publication in the Federal Reporter. That opinion is available at 318 Fed. Appx. 906, and is reproduced in the appendix hereto ("App.") at App. 1. The order of the Federal Circuit denying Wayne-Dalton's request for panel rehearing and rehearing *en banc* is unreported and is reproduced at App. 71.

Opinions of the district court were issued on January 23, 2008, April 29, 2008, and August 14, 2008, and were not reported. Those opinions are reproduced at App. 40, App. 27, and App. 4, respectively.

Jurisdiction

The judgment of the Federal Circuit was entered on March 31, 2009. App. 1. The Federal Circuit denied Petitioner Wayne-Dalton's combined petition for panel rehearing and rehearing *en banc* in its order dated June 1, 2009. App. 71. The jurisdiction of the Federal Circuit was based on 28 U.S.C. §§ 1331 and 1338(a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Constitutional and Statutory Provisions Involved

United States Constitution, Art. III, § 1, cl. 1

The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish.

United States Constitution, First Amendment

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.

United States Constitution, Fifth Amendment

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

United States Constitution, Seventh Amendment

In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any court of the United States, than according to the rules of the common law.

United States Code, Title 15, Section 1125(a)(1)

(a) Civil Action

(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities,

shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

Federal Circuit Rule 32.1(a)

Disposition of Appeal, Motion, or Petition. Disposition of an appeal may be announced in an opinion; disposition of a motion or petition may be announced in an order. An appeal may also be disposed of in a judgment of affirmance without opinion pursuant to Federal Circuit Rule 36. A nonprecedential disposition shall bear a legend designating it as nonprecedential. A precedential disposition shall bear no legend.

Federal Circuit Rule 32.1(b)

Nonprecedential Opinion or Order. An opinion or order which is designated as nonprecedential is one determined by the panel issuing it as not adding significantly to the body of law.

Federal Circuit "Practice Note" Accompanying Federal Circuit Rule 35

Nonprecedential Opinions. A petition for rehearing *en banc* is rarely appropriate if the appeal was the subject of a nonprecedential opinion by the panel of judges that heard it.

Federal Circuit Rule 36

Entry of Judgment – Judgement of Affirmance Without Opinion

The court may enter a judgment of affirmance without opinion, citing this rule, when it determines that any of the following conditions exist and an opinion would have no precedential value:

(a) the judgment, decision, or order of the trial court appealed from is based on findings that are not clearly erroneous;

(b) the evidence supporting the jury's verdict is sufficient;

(c) the record supports summary judgment, directed verdict, or judgment on the pleadings;

(d) the decision of an administrative agency warrants affirmance under the standard of review in the statute authorizing the petition for review; or

(e) a judgment or decision has been entered without an error of law.

Statement of the Case

Overview

Argument I: The Decisions of the Lower Courts Deepen a Conflict Between the Circuits, Violate Wayne-Dalton's Seventh Amendment Right to a Jury Trial, and Frustrate the Consumer Protection Purpose of the Lanham Act

"Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care." *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935). A "court errs if it substitutes itself for the jury, and, passing upon the effect of the evidence, finds the facts involved in the issue, and renders judgment thereon." *Baylis v. Travellers' Ins. Co.*, 113 U.S. 316, 320-321 (1885). Although the case before this Court merits such scrutiny, it has yet to receive it—with this Court being the last bastion for justice.

The district court, following the Sixth Circuit's departure from other circuits, treated the nature of an accused advertising statement as a matter of law, substituted itself for the jury, passed upon the effect of the evidence, and found facts involved in the issue and rendered judgment thereon—all of which led to the absurd result that a garage door having panel

interfaces which admit fingers to the extent that they can be crushed or severed is legally entitled to be advertised as "pinch resistant."

A Panel of the Federal Circuit, with a one-word judgment—and therefore without demonstrating it applied the appropriate *de novo* standard of review—affirmed the district court's grant of summary judgment to Amarr on Wayne-Dalton's claim for false advertising, further labeling its judgment "nonprecedential." By that one-word judgment and label, the Panel of the Federal Circuit indicated that it had determined the grant of summary judgment had been entered "without an error of law."[1] Thus, by its actions, the Federal Circuit affirmed a standard for the determination of the nature of an accused advertising statement, which converts a question of fact into a question of law, in violation of Wayne-Dalton's Seventh Amendment right to a trial by jury on this issue.

By its actions, the Federal Circuit has deepened a conflict between the law of the Sixth Circuit and that of at least the First, Second, Fourth and Seventh Circuits.

By its actions, the Federal Circuit has frustrated the consumer protection purpose of the false advertising provision of the Lanham Act, and

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[1] Petitioner Wayne-Dalton had argued on appeal both that the district court had erred as a matter of law, and that the district court had abused its discretion. As such, we must assume that the Federal Circuit, in affirming the district court's grant of summary judgment, found that the judgment had been entered without an error of law. Federal Circuit Rule 36(e).

indeed, given the factual circumstances in this case, has left consumers with the risk of serious hand injury.

Argument II: Nonprecedential Decisions are Unconstitutional

The district court's analysis of the factual and legal issues in this case spanned nearly fifty pages. App. 4-70. The Federal Circuit, in contrast, disposed of Wayne-Dalton's appeal with just one word in its March 31, 2009 Order ("the decision"). App. 1. The decision bears the legend "NOTE: This disposition is nonprecedential" and was not selected for publication in the *Federal Reporter*, thereby making it a so-called "unpublished" opinion.[2] App. 1. The decision was not signed by a judge from the Panel that decided the case, but rather was signed with the electronic signature of the Federal Circuit's Clerk ("/s/ Jan Horbaly"). App. 1.

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[2] Notwithstanding, the decision is available in West Publishing's *Federal Appendix*, the case law reporter containing the judicial opinions of the United States courts of appeals that have not been selected for publication. Thus, this petition is not concerned with the fiction that the decision is "unpublished." And because of Federal Rule of Appellate Procedure 32.1, this petition is not concerned with the recent practice of prohibiting *citation* to "nonprecedential" opinions. The petition is concerned, however, with the Federal Circuit's conclusion that the decision is somehow "nonprecedential."

Facts

Petitioner Wayne-Dalton Corp. ("Wayne-Dalton") and Respondent Amarr Company ("Amarr") are competitors in the garage door industry. In the late 1990's, the United States Consumer Product Safety Commission urged the industry to develop a "pinch resistant" garage door to address an identified public safety issue—the serious injuries that occur when fingers are inserted into the joints or interfaces between panels as the door is moved between open and closed positions. Wayne-Dalton was the first to develop and advertise a "pinch resistant" door, for which, in 1998, it was awarded the CPSC "Chairman's Commendation for Significant Contributions in Product Safety...for innovative garage door design that will help prevent injury to consumers." To compete, Amarr followed with a single door in 1999, and soon undertook the development and promotion of *an entire line* of pinch resistant doors.

Amarr has since used the term "pinch resistant" in virtually all of its advertising. The advertisements have been set in the context of various words, phrases and illustrations giving further life and meaning to the term, including: an image of a person's fingers positioned safely near the intersection of two adjacent garage door panels, the trademarked phrase "DuraSafe" in the text, a "DuraSafe" logo, "exceeding industry standards," "neither fingers nor weather gets in," "assures pinch-resistance both inside and out," a photo of a little girl or children, "inspired by the little things, little hands," "meet the inspiration behind our DuraSafe

system," "no room for even the smallest fingers," "designed to reduce the risk of serious finger and hand injuries," "pinch resistant technology that was developed to help keep fingers from getting pinched between sections when the door is closing," and "meet[s] future DASMA 116 requirements." While the advertising context used in association with the term "pinch resistant" varied over time, the term "pinch resistant" and associated message have been consistent.

Amarr's advertisements targeted ultimate consumers (usually homeowners), dealers, and big box retailers such as Lowe's. In most cases, Amarr's dealers adopted Amarr's advertising phrases and its imagery, verbatim. Lowe's adopted advertising prepared by Amarr following a presentation by Amarr in which it touted "pinch resistant" as its products' number one feature –a feature that would allow Lowe's to differentiate from its primary competitor, Home Depot.

The relevant "industry standard" touted to have been "exceed[ed]" within the context of Amarr's advertising is DASMA 116. Amarr actively participated in the development of this objective metric for assessing the "pinch resistant" feature of garage doors, voluntarily adopted it, and then identified it as having been "exceed[ed]" in its advertising. Even if consumers know little, if anything, about DASMA 116, they know the meaning of "pinch resistant" from the host of advertising phrases and images used by Amarr (i.e., the context), and that there is an industry standard

relating to "pinch resistant"—and that Amarr's doors exceed it.

Nineteen Amarr doors were tested from August 25, 2005, through July 2006. Each failed to satisfy the objective criteria of DASMA 116. Further, the joint or panel interfaces of each fully admitted the fingers of an adult, where they could not only be pinched, but crushed or severed. This is inconsistent with the meaning of "pinch resistant" conveyed by that term *in the context* of Amarr's advertisements. A panel joint of Amarr's "pinch resistant" door is shown below as fully accepting insertion of adult fingers to the extent that they could be crushed or severed:



District Court Proceedings

On July 21, 2006, Wayne-Dalton filed its complaint against Amarr under the Lanham Act, Title 15, United States Code, § 1125(a)(1)(B),

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charging Amarr, in part, with false advertising of at least certain of its garage doors, claiming them as complying with Standard 116 of DASMA, being "pinch resistant," "child safe" and having "finger protecting panels." Wayne-Dalton's prayer for relief pertaining to its false advertising claim included a request for an award of damages (to be trebled), corrective advertising, and an injunction.

On January 23, 2008, the district court granted, in part, Amarr's motion for summary judgment on Wayne-Dalton's false advertising claim, denied Wayne-Dalton's motion for summary judgment on Amarr's liability for literal false advertising, and granted Amarr's motion for summary judgment on Wayne-Dalton's inability to recover damages for its false advertising claim. App. 40-70. In its rulings, the district court took a belt-and-suspenders approach to dismiss the case. It made factual determinations not only as to the nature of the accused advertisements, but as to the defense of laches, as well—even though the district court did not, and could not, point to a date or event that commenced the two-year laches period.

On January 31, 2008, Wayne-Dalton filed a motion for reconsideration requesting the district court to have the issue tried before a jury, which the district court denied on April 29, 2008. App. 24-32.

Finally, the district court denied Wayne-Dalton's request for injunctive relief, and entered final judgment against Wayne-Dalton on August 14, 2008. App. 4-26.

Federal Circuit Proceedings

On March 31, 2009, the Federal Circuit entered a one-word judgment "AFFIRMED," further stating "NOTE: This disposition is nonprecedential." App. 1.

Reasons for Granting the Writ

I. The Decisions of the Lower Courts Deepen a Conflict Between the Circuits, Violate Wayne-Dalton's Seventh Amendment Right to a Jury Trial, and Frustrate the Consumer Protection Purpose of the Lanham Act.

A. The Decisions of the District Court and Federal Circuit Deepen a Conflict with the Law of the First, Second, Fourth and Seventh Circuits.

In this case a jury never determined whether garage doors having panel interfaces that admit the fingers of an adult to the extent that they can be crushed or severed may be legally advertised as "pinch resistant." Rather, the decision was made by the district court "as a matter of law," without due regard to context and with the district court weighing the facts. In *American Council of Certified Podiatric Physicians and Surgeons v. American Board of Podiatric Surgery, Inc.*, the Sixth Circuit departed from the law of false advertising as followed by at least the First, Second, Fourth and Seventh Circuits, as well as learned scholars, and

ruled that the issue of the nature of an accused advertising statement is initially a matter of law for the court, and only thereafter a matter of fact:

> Whether or not a statement is ambiguous would seem to be a question of law, as it is in contract interpretation. ([U]nder Ohio law, determination of whether a contractual term is ambiguous is a question of law, not fact). On the other hand, the Second Circuit has held that whether or not a statement is facially false is a question of fact. These two rules do not conflict because determining what meaning(s) words facially convey requires no weighing of evidence, while determining whether facts exist so as to make a statement true does require weighing evidence. Thus, the initial determination concerning whether a statement is ambiguous is a matter of law, while the determination as to whether facts exist so as to justify the statement is a question of fact. The testimony plaintiff points to concerns the initial determination of ambiguity and is therefore irrelevant to the question of whether "purporting" is ambiguous, a question of law.

American Council of Certified Podiatric Physicians and Surgeons v. American Board of Podiatric Surgery, Inc, 185 F.3d 606, 615 n. 2 (6th Cir. 1999) (internal citations omitted).

The Sixth Circuit's approach is inconsistent with the law of several other circuits, which have held that the determination of the nature of an accused of statement is an issue of fact. *See*, *Clorox Co. Puerto Rico v. Proctor & Gamble Commercial Co.*, 228 F.3d 24, 34 (1st Cir. 2000)("Whether an advertisement is literally false is typically an issue of fact...At least two factual questions must be answered in evaluating the accuracy of any particular advertisement. First, a factfinder must determine the claim conveyed by the advertisement...Once the claim made by the advertisement has been determined, the factfinder must then evaluate whether that claim is false." (internal citations omitted)); *Johnson & Johnson v. GAC Int'l, Inc.*, 862 F.2d 975, 979 (2d Cir. 1988)("In *Coca-Cola* [*Co. v. Tropicana Prods., Inc.*, 690 F.2d 312, 317-18 (2d Cir. 1982)], this court held that a trial court's finding of facial falsity *vel non* was an issue of fact."); *C.B. Fleet Co. v. Smith Kline Beecham Consumer Healthcare, L.P.*, 131 F.3d 430, 434 (4th Cir. 1997)("Whether an advertisement is literally false is a question of fact."); *Mead Johnson & Co. v. Abbott Laboratories*, 209 F.3d 1032, 1034 (7th Cir. 2000)("...[W]hether a claim is either 'false' or 'misleading' is an issue of fact rather than law."); and 1A *Callmann on Unfair Comp., Tr. & Mono.* § 5:23 (4th ed.)("The nature of the falsity [of an advertisement] is a question of fact.")

While typically a conflict must be inferred from an analysis of allegedly conflicting cases, in *Podiatric Physicians*, the Sixth Circuit expressly recognized its departure from the Second Circuit's holding that whether or not a statement is facially

false is a question of fact. The Sixth Circuit, however, reasoned that its departure was not a "conflict because determining what meaning(s) words facially convey requires no weighing of evidence." *Podiatric Physicians*, 185 F.3d at 615, n 2.

Contrary to its reasoning, the Sixth Circuit's departure from the Second Circuit's holding is, indeed, a "conflict" for the simple reason that the context of an accused false term is essential to the determination of its meaning. As most poignantly stated by the Second Circuit, "Fundamental to any task of interpretation is the principle that text must yield to context. Recognizing this, the Supreme Court long ago inveighed against 'the tyranny of literalness.'" *Avis Rent A Car Sys., Inc. v. Hertz Corp.*, 782 F.2d 381, 385 (2d Cir. 1986.) Quoting Judge Learned Hand, the Second Circuit explained further,

> "[t]here is no surer way to misread any document than to read it literally," as well as his oft-cited admonition that "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary." These and similar invocations against literalness, though delivered most often in connection with statutory and contract interpretation, are relevant to the interpretation of any writing, including advertisements...a court must "consider the advertisement in its entirety and not...engage in disputatious dissection. The entire

> mosaic should be viewed rather than each tile separately."

Id. (internal citations omitted). *See also*, 1A *Callmann* § 5:23.

Cardinally, the concepts of "context" and "mosaic" were lost on the Federal Circuit. When the issue of the advertising mosaic was presented at the hearing on appeal, the Panel's only response was "I don't understand that. So are you complaining about these other statements or not?" *Audio Recording of Oral Argument in Case No. 2008-1585, Wayne-Dalton Corp. v. Amarr Co.*, 3/30/09, http://oralarguments.cafc.uscourts.gov/mp3/2008-1585.mp3 at 06:39 – 06:49 (accessed 5/5/09). Following the pattern of the district court, the Panel then treated the words and phrases of the advertising context as separately actionable statements:

> "Some of the statements, put aside pinch resistant, the problem is that some of the statements seem to be susceptible of a finding of literal falsity of a jury..." *Audio Recording of Oral Argument* at 18:58 – 19:12;
>
> "Do you agree with me that those are susceptible to being found [to be literally false]?" *Audio Recording of Oral Argument* at 19:22 – 19:26; and
>
> "You don't need evidence from consumers, just on the face of it that they can be susceptible to a finding of

> literal falsity given the fact that fingers do seem to be able to get in." *Audio Recording of Oral Argument* at 19:31 – 19:42.

Indeed, given the broad language of the Lanham Act false advertising provision ("in commercial advertising or promotion"), "context" is necessarily more than just the text of an advertisement, may be broader than the four corners of a single advertisement, and, may even be as broad as an advertisement campaign. 15 U.S.C. § 1125(a)(1)(B) While it is well settled law that the construction of "written instruments" is with the court, where the instrument's effect depends not merely on its construction and meaning, but upon extrinsic facts and circumstances (both also being aspects of "context"), the inferences to be drawn *must* be left to a jury. *Goddard v. Foster*, 84 U.S. (17 Wall.) 123, 142 (1872).

That the conflict is real is verified by the decisions below, and the absurdity of a decision that would allow a garage door having panel interfaces that could crush or sever fingers to be legally advertised as "pinch resistant." Given the context of the advertisements at issue, what causes a district court to ask "What does it mean to 'resist' pinching? Must a door 'resist' pinching both adults' fingers and childrens' (sic) fingers? Only fingers but not shirt sleeves? Is the door 'pinch resistant' because it avoids *being* pinched due to its flat panels?" (App. 34), and then remove these inquiries from the province of the jury? It is the unwarranted dissection of an accused false term from its context, sanctioned by the Sixth Circuit, that creates

practical difficulties for a district court, results in that district court weighing the evidence and, in the end, yields absurd results, such as occurred in this case. The Sixth Circuit approaches false advertising from a contract perspective (*Podiactric Physicians*, 185 F.3d at 615, n. 2), and not from tort. Yet, false advertising is a tort. *Gold Seal Co. v. Weeks*, 129 F. Supp. 928, 940 (D.D.C. 1955). This being the sanctioned Sixth Circuit approach, the district court's error is certain to be repeated.

As the conflict is real, it should be resolved by this Court, which has stated that a "principal purpose of which we use our certiorari jurisdiction...is to resolve conflicts among the Circuit Courts of Appeals" and which has incorporated this principle into its rules of practice. *See, Braxton v. United States*, 500 U.S. 344, 347 (1991) and S. Ct. R. 10(a).

B. The Decisions of the District Court and Federal Circuit Have Violated Wayne-Dalton's Seventh Amendment Right to a Trial by Jury on the Factual Issues of the Nature of the Accused Advertising Statements and Laches.

The Seventh Amendment provides: "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved."

This Court has consistently interpreted the phrase "suits at common law" to refer to "suits in

which legal rights [are] to be ascertained and determined, in contradistinction to those where equitable rights alone [are sought to be] recognized, and equitable remedies [to be] administered." *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 41 (1989), citing *Parsons v. Bedford*, 3 Pet. 433, 447 (1830) (internal citations omitted); *See also*, *Chauffeurs Local 391 v. Terry*, 494 U.S. 558, 564-65 (1990). In determining whether an action is "legal" or "equitable" for Seventh Amendment purposes, a court (1) compares the statutory action to eighteenth century actions brought in the courts of England prior to the merger of the courts of law and equity; and (2) examines the remedy sought to determine if it is legal or equitable. *Granfinanciera,* 492 U.S. at 42. The second stage of the analysis is more important than the first. *Id.* When considering rights and remedies not founded in the common law of 1791, the right of action should be analogized to its historical counterpart, at law or in equity, for the purpose of determining whether there is a right of jury trial, unless Congress has expressly prescribed the mode of trial. *Luria v. United States*, 231 U.S. 9, 27-28 (1913).

False advertising is analogous to common law actions against injurious falsehoods such as trade libel and slander of title. In *Flint et al. v. Hutchinson Smoke Burner Co.*, the Supreme Court of Missouri stated that "slander of title" is an action at law: "[w]here the plaintiff possesses an estate or interest in any real or personal property, an action lies against any one who maliciously comes forward and falsely denies or impugns the plaintiffs' title thereto, if thereby damage follows to the plaintiff."

Flint et al. v. Hutchinson Smoke Burner Co., 19 S.W. 804, 805 (MO 1892).

This has been acknowledged in the federal courts:

> In *Flint*... the court held that the question of libel should be determined by a jury in an action at law, and that after a verdict for the plaintiff he might have an injunction to restrain the further publication of that which the jury found to be actionable libel or slander.

American Malting Co. v. Keitel, 209 F. 351, 356 (2d Cir. 1913) (internal citations omitted).

"Trade libel" is "trade defamation that is written or recorded" (*Black's Law Dictionary* 1530 (8th Ed. 2004)), and is clearly similar to the Lanham Act's prohibition against false advertising. Trade libel is also a matter of law that is tried to a jury. *American Malting*, 209 F. at 356-357.

False advertising under the Lanham Act provides remedies for false statements in advertising that harm competitors and consumers, and is therefore analogous to common law actions against injurious falsehoods dating back to the eighteenth century. These common law actions were tried to a jury, and therefore the analogous claims brought under the Lanham Act must also be tried to a jury.

Additionally, this Court has stated that relief consisting of actual and punitive damages is the

traditional form of relief offered in the *courts of law*. *Curtis v. Loether*, 415 U.S. 189, 196 (1974). Further, it is an established principle that where both legal and equitable issues are presented in a single case, only under the most imperative circumstances can the right to a jury trial of legal issues be lost through prior determination of an equitable claim, necessitating the trial of common factual issues to the jury. *Dairy Queen v. Wood*, 369 U.S. 469, 472-73, (1962). This principle applies, as well, to the laches issue which was determined by the district court, below.

This Court has also recognized that not all issues arising in a jury trial are necessarily jury issues. *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 376 (1996). Whether an issue may be resolved by the court, or must be reserved for the jury, turns on whether a determination by the jury is necessary to preserve the substance of the common law right of trial by jury. *Id.* It may be argued that the Sixth Circuit's decision in *Podiatric Physicians* addresses only whether the initial issue of the nature of the accused advertising statement is, itself, necessarily a jury issue. But, given the requirements of "context" and the similarity to eighteenth century common law actions, a jury must shoulder this responsibility as necessary to preserve the substance of the common law right of trial by jury.

Under the holding below, it will be commonplace to deny litigants their constitutional right to a jury trial on the nature of an accused advertising statement, a critical issue in false

advertisement cases. This Court should grant the petition to end the conflict created by this case on what is an important and recurring question of federal law.

C. The Decisions of the District Court and Federal Circuit Frustrate the Purpose of the False Advertising Provision of the Lanham Act.

In amending the Lanham Act in 1988 to broaden the language and codify the prohibition against false and misleading advertising, Congress endorsed and highlighted the creation of a federal law of unfair competition. S. Rep. No. 100-515 at 40. The Trademark Law Revision Act of 1988 had as its stated purpose to protect legitimate business and the consumers of the country. *Id.*; *See also*, Thomas W. Edman, *Lies, Damn Lies, And Misleading Advertising: The Role of Consumer Surveys In the Wake of* Mead Johnson v. Abbott Labs, 43 Wm. & Mary L. Rev. 417, 444 (2001). Indeed, as advertising has taken on a central role in our national economy, the false advertising prohibition in the Lanham Act has become one of the primary vehicles for protecting consumers from false or misleading advertising. Uncertainty (confusion and conflict) about the federal law governing advertising, such as that created by the Sixth Circuit's departure from the consideration of the nature of an accused advertising statement as an issue of fact,as demonstrated by the district court decision that allows a garage door that threatens severe hand injuries to be legally

advertised as "pinch resistant," does nothing to forward the purpose of protecting the consumers of the country. Instead, it frustrates the vital role advertising is supposed to play in the national economy by maintaining the clean flow of commercial information. *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 561-62 (1980). Indeed, under the circumstances of this case, it leaves the public at greater risk than it would have been in the absence of the advertising altogether. In sum, this Court should grant the petition to dispel the confusion by establishing the clear principle that the nature of an accused advertising statement is a matter of fact for a jury, which will serve to promote the consumer protection purpose of the false advertising provision of the Lanham Act.

II. The Federal Circuit's Practice of Issuing Nonprecedential Decisions Violates The Constitution.

> *To avoid an arbitrary discretion in the courts, it is indispensable that they should be bound down by strict rules and precedents, which serve to define and point out their duty in every particular case that comes before them...*
>
> -Alexander Hamilton, The Federalist No. 78

> *A more alarming doctrine could not be promulgated by any American court, than that it was at liberty to disregard all former rules and decisions, and to*

> *decide for itself, without reference to the settled course of antecedent principles.*
>
> - Justice Joseph Story

The Federal Circuit disposed of Wayne-Dalton's appeal with a one-word judgment it labeled "nonprecedential."

This is insufficient. The Federal Circuit's practice of issuing unpublished, nonprecedential decisions is constitutionally infirm in three significant ways. First, the practice exceeds the "judicial power" conferred on the judiciary by Article III. Second, the practice violates the principles of the Equal Protection Clause. Third, the practice violates the First Amendment and the Due Process Clause of the Fifth Amendment. Finally, the practice is ripe[3] for Constitutional review and has

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[3] *See*, David R. Cleveland, *Draining The Morass: Ending The Jurisprudentially Unsound Unpublication System*, 92 Marq. L. Rev. 685, 686 (2009); David R. Cleveland, *Overturning The Last Stone: The Final Step In Returning Precedential Status To All Opinions*, 10 J. App. Prac. & Process, 101 (2009); Richard B. Cappalli, *The Common Law's Case Against Non-Precedential Opinions*, 76 S. Cal. L. Rev. 755 (2003); Drew R. Quitschau, Anastasoff v. United States: *Uncertainty In The Eighth Circuit – Is There A Constitutional Right To Cite Unpublished Opinions*, 54 Ark L. Rev. 847 (2002); Penelope Pether, *Constitutional Solipsism: Toward A Thick Doctrine Of Article III Duty; Or Why The Federal Circuits' Nonprecedential Status Rules Are (Profoundly) Unconstitutional*, 7 Wm. & Mary Bill Rts. J. 955 (2009); Charles E. Carpenter, *The No-Citation Rule For Unpublished Opinions: Do The Ends Of Expediency For Overloaded Appellate Courts Justify The Means Of Secrecy*, 50 S.C. L. Rev. 235 (1998).

been wanting for this Court's attention since the 1970's.[4]

A. The Federal Circuit Exceeds Its "Judicial Power" When It Issues Nonprecedential Decisions.

All cases decided by the federal courts are precedent.

The Eight Circuit has acknowledged this fact of American law: "Inherent *in every judicial decision* is a declaration and interpretation of a general principle or rule of law. This declaration of law is authoritative to the extent necessary for the decision, and must be applied in subsequent cases to similarly situated parties." *Anastasoff v. United States*, 223 F.3d 898, 899-900 (8th Cir. 2000) (internal citations omitted, emphasis added), *vacated as moot*,[5] 235 F.3d 1054 (8th Cir. 2000).

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[4] The Advisory Council on Appellate Justice, Committee on Use of Appellate Court energies drafted a report, *Standards for Publication of Judicial Opinions: A Report of the Committee on Use of Appellate Court Energies of the Advisory Council on Appellate Justice* (1973), and acknowledged that the practice of limiting the printing of, and citation to, appellate court decisions presented a "morass of jurisprudence" that it did not address. *See also*, Cleveland, *Draining the Morass*, *supra* n. 3 at 686-687.

[5] The case became moot when the United States paid appellant Anastasoff her income tax refund in full: "Here, the case having become moot, the appropriate and customary treatment is to vacate our previous opinion and judgment, remand to the District Court, and direct that Court to vacate its judgment as moot." 235 F.3d at 1056.

So too has the Chief Judge of the Tenth Circuit: "*Each ruling*, published or unpublished, involves the facts of a particular case and the application of law--to the case. *Therefore all rulings of this court are precedents*, like it or not, and we cannot consign any of them to oblivion by merely banning their citation." *In re Rules of U.S. Ct. of App. for 10th Cir., Adopted Nov. 18, 1986*, 955 F.2d 36, 37 (10th Cir. 1992) (Halloway, Chief Judge, and Barrett & Baldock, JJ., dissenting, emphasis added).

This requirement that all cases decided by the federal courts are precedent flows directly from the Constitution. Article III, Section 1, Clause 1 of the United States Constitution states: "The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish." U.S. Const. art. III, § 1, cl. 1. Although "judicial power" is not further defined, when the Constitution was adopted and ratified "judicial power" was defined and constrained by the doctrine of precedent, thereby limiting the power delegated to the courts by Article III. *Anastasoff*, 223 F.3d at 900.

The importance of precedent to the common law as a tool for judicial decision-making around the time this nation was founded is well documented by legal historians and has been discussed by the courts. *Anastasoff*, 223 F.3d at 900: "The doctrine of precedent was well-established by the time the Framers gathered in Philadelphia"; Morton J. Horwitz, *The Transformation of American Law: 1780 – 1860*, 1 (1977): "[In eighteenth century America],

the common law was conceived of as a body of essentially fixed doctrine to be applied in order to achieve a fair result between private litigants in individual cases"; 1 Sir William W. Blackstone, *Commentaries on the Laws of England* *69 (1765): "For it is an established rule to abide by former precedents, where the same points come again in litigation: as well to keep the scale of justice even and steady, and not liable to waver with every new judge's opinion..."; 1 Blackstone, *Commentaries* *70:

> From the sixteenth century onwards, if not earlier, we may say that decided cases are regarded as a definite authority, which, at least in the absence of special reasons to the contrary, must be followed for the future. For the last three hundred years, at any rate, the decisions of judges of the higher courts have had a binding force for all similar cases which may arise in the future.

By the eighteenth century, it was well understood that a judge's duty was to determine the law, and to follow it. Thus precedent provided a prescriptive and limiting framework to decision-making. *See*, 1 Blackstone, *Commentaries*, *69-70 (emphasis added):

> For it is an established rule to abide by former precedents, where the same points come again in litigation: ... because the law in that case being solemnly declared and determined, what before was uncertain, and perhaps

> indifferent; is now become a permanent rule, which it is not in the breast of any subsequent judge to alter or vary from; according to his private sentiments: *he being sworn to determine not according to his own private judgment, but according to the known laws and customs of the land; not delegated to pronounce a new law, but to maintain and expound the old one.*

Contemporary American jurists were committed to these ideas as well. Alexander Hamilton in *The Federalist No. 78* states: "The courts must declare the sense of the law; and if they should be disposed to exercise WILL instead of JUDGMENT, the consequence would equally be the substitution of their pleasure to that of the legislative body"; and: "To avoid an arbitrary discretion in the courts, it is indispensable that they should be bound down by strict rules and precedents, which serve to define and point out their duty in every particular case that comes before them..." And in *The Federalist No. 81*, Hamilton states that a reviewing court "pronounces the law arising upon" the facts of a case. Justice Joseph Story in his *Commentaries on the Constitution of the United States* § 377 discusses the strength and tradition of precedent, and denounces the possibility of another mode of decision-making:

> The case is not alone considered as decided and settled, but the principles of the decision are held, as precedents and authority, to bind future cases of

> the same nature. *This is the constant practice under our whole system of jurisprudence.* Our ancestors brought it with them when they first emigrated to this country, and it is, and always has been, considered as the great security of our rights, our liberties, and our property. It is on this account that our law is justly deemed certain, and founded in permanent principles, and not dependent upon the caprice or will of particular judges. A more alarming doctrine could not be promulgated by any America court, than that it was at liberty to disregard all former rules and decisions, and to decide for itself, without reference to the settled course of antecedent principles.

1 Joseph Story, *Commentaries on the Constitution of the United States* § 377 (5th ed. 1891) (emphasis added).

Precedent was clearly central to "judicial power" under the common law when the Constitution was adopted and ratified. Judge Arnold of the Eighth Circuit reached the same conclusion in *Anastasoff*:

> This known course of proceeding, this settled habit of thinking, this conclusive effect of judicial adjudications, was in the full view of the framers of the constitution. It was required, and enforced in every state in the Union;

> and a departure from it would have been justly deemed an approach to tyranny and arbitrary power, to the exercise of mere discretion, and to the abandonment of all the just checks upon judicial authority.

Anastasoff, 223 F.3d at 904.

All cases decided by the federal courts are precedent. Precedent provides both the method by which cases are to be decided (articulating the applicable rule of law, and applying the facts of a case to that rule), as well as a limit on how cases may be decided (cases must be decided by application of the facts of a case to the applicable rule of law). Precedent, then, limits the "judicial power" conferred on the federal courts by Article III of the Constitution.

The Federal Circuit's practice of issuing unpublished decisions and denying their precedential value flies in the face of these constitutional limits on judicial power. The Federal Circuit wishes to free itself from following its own decisions by denying the precedential status of a past decision for future cases. The Federal Circuit is saying "We may have decided this question the opposite way yesterday, but this does not bind us today." This exceeds the judicial power conferred on the Federal Circuit, and represents the alarming doctrine denounced by Justice Story. *Anastasoff* 223 F.3d at 904, 1 Story, *Commentaries* § 377.

And, where as here the Federal Circuit's decision is nothing more than a one-word judgment, there is no assurance that the court has identified and applied the relevant law, let alone followed it. The Federal Circuit's decision did not articulate what rule of law applies given the facts of this case, and did not apply the facts to the applicable law. Thus, the parties and the public are prohibited from knowing what the rule of law is, and how that rule of law was applied to the given facts. And, the parties and public are also deprived of considering whether the court has actually followed the law. Judicial power does not extend this far. All courts are limited by the doctrine of precedent, and the Federal Circuit must comply with its requirements. Issuing a decision that satisfies the traditions of precedent is especially worthwhile where, as here, the parties dispute the applicable law.

The Federal Circuit exceeded its judicial power, and this Court should grant the petition and address this issue of great importance.

B. The Federal Circuit Denies Litigants The Equal Protection of The Laws When It Issues Nonprecedential Decisions.

Moreover, the Federal Circuit's practice of issuing nonprecedential decisions violates the Equal Protection Clause because it treats similarly situated litigants in a disparate manner. "The Equal Protection Clause of the Fourteenth Amendment commands that no State shall 'deny to any person within its jurisdiction the equal protection of the

laws,' which is essentially direction that all persons similarly situated should be treated alike." *City of Cleburne v. Cleburne Living Ctr.*, 473 U.S. 432, 439 (1985). The protections afforded by the Equal Protection clause apply by analogy to the federal government through the due process guarantees of the Fifth Amendment. *See, Bolling v. Sharpe*, 347 U.S. 497, 500 (1954) ("In view of our decision that the Constitution prohibits the states from maintaining racially segregated public schools, it would be unthinkable that the same Constitution would impose a lesser duty on the Federal Government."). The federal government, including the Federal Circuit, may not deny to any person the equal protection of the laws.

By issuing nonprecedential decisions, a court is saying "We may have decided this question the opposite way yesterday for one litigant, but this does not bind us today for a different litigant." This is not mere hyperbole – two cases from the Fifth Circuit demonstrate how a court's practice of issuing nonprecedential opinions actually lead to the disparate treatment of *identically* situated litigants.

In the case of *Anderson v. Dallas Area Rapid Transit*, the district court held that "DART is a political subdivision of the state of Texas, and is therefore immune from suit under the Eleventh Amendment." *Anderson v. Dallas Area Rapid Transit*, No. CA3:97-CV-1834-BC, 1998 WL 686782, at *7 (N.D.Tex. Sept. 29, 1998). The Fifth Circuit affirmed in an "unpublished" decision that it declared "is not precedent." *Anderson v. Dallas Area Rapid Transit*, 180 F.3d 265 (5th Cir. 1999) (per

curiam). The Supreme Court subsequently denied Anderson's cert petition, 528 U.S. 1062 (1999).

In *Williams v. Dallas Area Rapid Transit*, the district court dismissed the case *sua sponte* for lack of subject matter jurisdiction. In the employee's appeal, the Fifth Circuit held that "DART is not an arm of the state for purposes of the Eleventh Amendment," and therefore "DART is not immune from Williams's claim." *Williams v. Dallas Area Rapid Transit*, 242 F.3d 315, 319-322 (5th Cir. 2001). Regarding that same court's earlier opposite decision in *Anderson*, the Fifth Circuit stated in a footnote that its previous decision is "neither binding nor persuasive." *Id.* at 319, n. 1. The denial of the petition for rehearing *en banc* drew a dissent signed by three circuit judges, and stated: "The refusal of the *en banc* court to rehear this case *en banc* is unfortunate, for this is an opportunity to revisit the questionable practice of denying precedential status to unpublished opinions." *Williams v. Dallas Area Rapid Transit*, 256 F.3d 260, 260 (5th Cir. 2001) (Smith, Circuit Judge, with Jones and DeMoss dissenting).

The *Anderson* and *Williams* cases provide a specific example of the abuse that follows a court regarding its own prior decisions as nonprecedential. It is what Justice Story and the Eight Circuit abhor: a court that views itself at liberty to disregard all former rules and decisions, and to decide for itself, without reference to the settled course of antecedent principles. *Anastasoff*, 223 F.3d at 904. For these cases, the Fifth Circuit is saying "We may have decided this question the opposite way yesterday for a litigant, but this does not bind us today for *the same* litigant."

Parties are denied the equal protection of the laws when courts are free to disregard their past decisions and issue decisions that reflect the will of the court, and not the judgment required by the historically established rule of law. A nonprecedential decision *ipso facto* violates the Equal Protection Clause because it says that indistinguishable future cases may not be, but may be, decided the same way. The Federal Circuit's practice undermines the constitutional promise that litigants will be treated equally under the law.

The Federal Circuit denied Wayne-Dalton the equal protection of the laws by issuing its nonprecedential one-word judgment. The Federal Circuit's decision does not indicate that it was decided based on a legal principle of equal application, and expressly states that it is "nonprecedential." This Court should grant this petition and address this issue of great importance.

C. The Federal Circuit Denies Litigants Their Fundamental Right Of Access To The Courts And Due Process Requirements When It Issues Nonprecedential Decisions.

The First Amendment provides parties with a fundamental right of access to the courts. *Bounds v. Smith*, 430 U.S. 817, 828 (1977). And while the Supreme Court has not held that there is a constitutional right to appeal, if the law creates such a right, the government cannot create barriers that limit the ability of parties to exercise this right. *See, Griffin v. Illinois*, 351 U.S. 12, 18 (1956), *Eskridge v. Washington*, 357 U.S. 214, 216 (1958), *Douglas v.*

California, 372 U.S. 353, 357-358 (1963). Government actions that limit fundamental rights are subject to strict scrutiny review. *See*, *Clark v. Jeter*, 486 U.S. 456, 461 (1988).

The Fifth Amendment prohibits the government from depriving a person of "life, liberty, or property, without due process of law." U.S. Const. amend. V. This clause has been held to include both substantive and procedural components.

Because the equal protection clause applies to the Federal government by analogy through the Fifth Amendment due process clause, a substantive due process analysis is similar to an equal protection analysis.

The tradition and values of the doctrine of precedent are implicit in the concepts of ordered liberty, as incorporated into the "judicial power" recited in Article III of the Constitution ("The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish."). A party's due process rights, then, are infringed by a violation of the doctrine of precedent. *See*, *Griswold v. Connecticut*, 381 U.S. 479, 500 (1965) (Harlan, J., concurring) ("In my view, the proper constitutional inquiry in this case is whether this Connecticut statute infringes the Due Process Clause of the Fourteenth Amendment because the enactment violates basic values implicit in the concept of ordered liberty.") (internal quotations and citations omitted).

The practice of issuing nonprecedential decisions infringes upon a party's due process rights because it violates the doctrine of precedent – something implicit in our concept of ordered liberty. In particular, the practice purports to set future courts free from following what has been already decided, an idea that violates the basic values of precedent. In addition, a court's nonprecedential one-word judgment order is devoid of the finding and application of law that is the hallmark of tradition and precedent.

In addition to substantive due process, due process guards against procedural actions that abrogate well-established common law procedures without providing an appropriate substitute:

> Oregon's abrogation of a well-established common-law protection against arbitrary deprivations of property raises a presumption that its procedures violate the Due Process Clause. As this Court has stated from its first due process cases, traditional practice provides a touchstone for constitutional analysis...
>
> Judicial review of the amount awarded was one of the few procedural safeguards which the common law provided against that danger. Oregon has removed that safeguard without providing any substitute procedure and without any indication that the danger of arbitrary awards has in any way

> subsided over time. For these reasons, we hold that Oregon's denial of judicial review of the size of punitive damages awards violates [due process].

Honda Motor Co. v. Oberg, 512 U.S. 415, 430-432 (1994) (internal citations omitted). As has already been established, the doctrine of precedent is a well-established common law procedure, and is the hallmark of valid judicial judgment. Thus, the Federal Circuit's practice of issuing nonprecedential decisions abrogates the common law traditions of precedent, and presumptively violates due process. First, the practice purports to set future courts free from following what has been already decided, an idea that is wholly at odds with the tradition of precedent. Second, where the decision is only a one-word judgment order, the decision is devoid of the finding of and application of the law that is the hallmark of the tradition of precedent. No substitute procedure is provided for what has been taken away – the Federal Circuit has simply disregarded the requirements of precedent implicit in the court's judicial power, and has denied Wayne-Dalton its due process.

Moreover, the Federal Circuit's practice of issuing nonprecedential decisions does not satisfy a strict scrutiny review. In order to survive strict scrutiny review, a governmental limitation on a fundamental right must be justified by a compelling governmental interest and be narrowly tailored to achieve that interest. *See, Wygant v. Jackson Board of Education*, 476 U.S. 267, 279-280 (1986). The Federal Circuit's practice of issuing nonprecedential

decisions fails both of these requirements. The practice serves no compelling governmental interest. The federal judiciary is obligated, through the judicial power vested in it, to follow the tradition of precedent. The government cannot claim a compelling interest in a practice that is at odds with its mandate, for nonprecedential decisions are antithetical to the tradition of precedent. But even if the Federal Circuit could articulate a compelling interest that its practice serves, the categorical classification of certain decisions as nonprecedential is not narrowly tailored. This is especially true where the Federal Circuit's decision is a one-word judgment order. If the Federal Circuit's decision-making is at all guided by the principles underlying the tradition of precedent, it could easily issue short decisions that contain the minimum to fulfill the traditions of precedent, and make explicit how the court reached its decision.

Wayne-Dalton's fundamental right of access to the courts and its due process rights were violated by the Federal Circuit's one-word judgment order. This Court should grant the petition and address this issue of great importance.

III. The Decisions of the District Court and Federal Circuit Are Wrong.

Issues of fact in false advertising cases brought under the Lanham Act are reserved for a jury. The Constitution guarantees this. The district court's opinion shows how it disregarded this limitation, and decided contested issues of fact, even citing to an affidavit for support. App. 9-14. The

Federal Circuit affirmed this blatant curtailment of the right to a jury trial.

Conclusion

The Federal Circuit's decision deepened a conflict among the circuits in an area of the law that demands uniformity, denied Wayne-Dalton its constitutional right to a jury trial, and frustrated the consumer protection purpose of the false advertising provision of the Lanham Act. By issuing a one-word judgment noted as "nonprecedential," the Federal Circuit exceeded its constitutional authority and denied Wayne-Dalton equal protection under the law, due process, and the fundamental right of access to the courts. Accordingly, a writ of certiorari should be issued and the decision below reversed or remanded.

Respectfully submitted,

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NO. _____

In The Supreme Court of the United States

WAYNE-DALTON CORP.,

Petitioner,

v.

AMARR COMPANY,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

APPENDIX

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[Entered: March 31, 2009]

NOTE: This disposition is nonprecedential.

United States Court of Appeals
for the Federal Circuit

2008-1585

WAYNE-DALTON CORP.,

Plaintiff-Appellant,

v.

AMARR COMPANY,

Defendant-Appellee.

Ray L. Weber, Renner, Kenner, Greive, Bobak, Taylor & Weber, of Akron, Ohio, argued for plaintiff-appellant. With him on the brief was Laura J. Gentilcore.

John F. Morrow, Jr., Womble Carlyle Sandridge & Rice, PLLC, of Winston-Salem, North Carolina, argued for defendant-appellee. With him on the brief was Kirk W. Watkins, of Atlanta, Georgia.

Appealed from: United States District Court for the Northern District of Ohio

Judge Sara Lioi

NOTE: This disposition is nonprecedential.

United States Court of Appeals
for the Federal Circuit

2008-1585

WAYNE-DALTON CORP.,

Plaintiff-Appellant,

v.

AMARR COMPANY,

Defendant-Appellee.

Judgment

ON APPEAL from: the United States District Court for the Northern District of Ohio

in CASE NO(S). 5:06-CV-01768.

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED:

Per Curiam (MAYER, DYK, and MOORE, Circuit Judges)

AFFIRMED. See Fed. Cir. R. 36.

ENTERED BY ORDER OF THE COURT

DATED March 31, 2009

/s/ Jan Horbaly
Jan Horbaly, Clerk

[Entered: August 14, 2008]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

WAYNE DALTON CORP., PLAINTIFF,	)	CASE NO. 5:06CV01768
	)	JUDGE SARA LIOI
vs.	)	MEMORANDUM OPINION AND ORDER
AMARR COMPANY, DEFENDANT.	)	

I. FACTUAL AND PROCEDURAL BACKGROUND

The facts surrounding this case are set forth in the Court's January 23, 2008, Memorandum Opinion and Order, familiarity with which is assumed. Wayne-Dalton and Amarr both manufacture garage doors. Wayne-Dalton brought a claim for false advertisement in violation of 15 U.S.C. § 1125, contending that Amarr falsely advertised Amarr's doors as "pinch resistant," and sought both damages and injunctive relief. The Court granted Amarr's motion for summary judgment on Wayne-Dalton's claim for damages because Wayne-Dalton failed to offer any evidence of actual consumer deception and because the claim was barred by the doctrine of laches. (Doc. No. 156.) The Court, however, did not grant summary judgment on WayneDalton's claim for injunctive

relief, finding that laches does not bar such a claim under Sixth Circuit law. (*Id.* at 15, citing *Nartron Corp. v. STMicroelectronics*, 305 F.3d 397, 412 (6th Cir. 2002)). Subsequent to the ruling, the Court instructed the parties to meet and confer regarding the claim for injunctive relief, with an eye toward resolution of the claim. Unable to resolve the issue, the parties filed a joint status report advising the Court that neither party believed a hearing would be worth the delay, expense and judicial effort that would be required, and suggested that they be permitted to file simultaneous briefs addressing the propriety of injunctive relief. The Court granted this request, and now considers the briefs as cross-motions for summary judgment.[1]

II. STANDARD OF REVIEW

This Court's analysis of the motion for summary judgment is governed by Rule 56(c) of the Federal Rules of Civil Procedure:

> The judgment sought should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact

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[1] Wayne-Dalton has filed a motion to strike Amarr's opposition to the issuance of an injunction. (Doc. No. 176.) Because the motion and reply in support of the motion (Doc. No. 180) appear to be an unnecessary and inappropriate attempt to file two more briefs (beyond the at least 12 previously filed) regarding the merits of this claim and to hurl unwarranted and inflammatory accusations at Amarr and its counsel, the Court hereby DENIES the motion. Furthermore, the Court will not consider the arguments contained within the motion and reply to the extent they provide further argument regarding the merits of the claim for injunctive relief

> and that the movant is entitled to judgment as a matter of law.

Id. The party opposing a motion for summary judgment made according to Rule 56 "may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e).

The entry of summary judgment is not a disfavored procedural shortcut, but instead is mandated by "the plain language of Rule 56(c) [. . .] after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The party opposing a motion for summary judgment may do so with "any of the kinds of evidentiary materials listed in Rule 56(c), except the mere pleadings themselves." *Id.* at 324. The nonmovant must show more than a scintilla of evidence to overcome summary judgment. *Matushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). Rather, the nonmoving party "must present significant probative evidence in support of its complaint to defeat the motion for summary judgment." *Moore v. Philip Morris Co.*, 8 F.3d 335, 339-40 (6th Cir. 1993). In addition, the movant is not required to file affidavits or other similar materials negating a claim on which its opponent bears the burden of proof, so long as the movant relies upon the absence of the essential element in the pleadings, depositions, answers to

interrogatories, and admissions on file. *Celotex*, 477 U.S. at 322.

In reviewing summary judgment motions, this Court must view the evidence in a light most favorable to the non-moving party to determine whether a genuine issue of material fact exists. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144 (1970); *White v. Turfway Park Racing Ass'n*, 909 F.2d 941, 943-44 (6th Cir. 1990). A fact is "material" only if its resolution will affect the outcome of the lawsuit. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

Determination of whether a factual issue is "genuine" requires consideration of the applicable evidentiary standards. Thus, in most civil cases the Court must decide "whether reasonable jurors could find by a preponderance of the evidence that the [non-moving party] is entitled to a verdict." *Id.* at 252. A non-movant is not permitted to rest upon the allegations in the complaint, but must produce affirmative evidence in support of each and every element of each claim. *Id.* at 150. In light of this standard, the Court considers Defendant's dispositive motion.

III. LAW AND ANALYSIS

In order to show it is entitled to a permanent injunction, Wayne-Dalton must demonstrate (1) that it succeeds on the merits of its claim and has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between Wayne-Dalton and Amarr, a remedy in equity is

warranted; and (4) that the public interest would not be disserved by a permanent injunction. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006). An evidentiary hearing is ordinarily required prior to the issuance of a permanent injunction, *United States v. McGee*, 714 F.2d 607, 613 (6th Cir. 1983), unless no factual issues remain for trial. *Moltan Co. v. Eagle-Picher Indus.*, 55 F.3d 1171, 1174 (6th Cir. Tenn. 1995). The decision to grant or deny a permanent injunction is within the Court's discretion and demands consideration of traditional principals of equity. *eBay*, 547 U.S. at 394; *Podiatric Physicians*, 185 F.3d at 618.

1. Wayne-Dalton's Claim for False Advertising Fails on the Merits

Wayne-Dalton's claim for false advertising arises under 15 U.S.C. § 1125, enacted as part of the Lanham Act. The statute provides, in relevant part:

> (a)(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or fase or misleading representation of fact, which—
>
> (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities

> Shall be liable in a civil action by any person who believes that he or she is or is likely to be damages by such act.

15 U.S.C. § 1125(a)(1) & (a)(1)(B) (1994).

The Sixth Circuit has set forth five elements that Wayne-Dalton must establish to prove its claim for injunctive relief: (1) Amarr made a misleading statement of fact concerning its product; (2) the statement tends to deceive a substantial portion of the intended audience; (3) the statement is material in that it will likely influence the deceived consumer's purchasing decisions; (4) the advertisements were introduced into interstate commerce; and (5) there is some causal link between the challenged statements and harm to Wayne-Dalton.[2] *American Council of Certified Podiatric Physicians and Surgeons v. American Board of Podiatric Surgery, Inc.*, 185 F.3d 606, 613 (6th Cir. 1999) (hereinafter "Podiatric Physicians"); *Balance Dynamics v. Schmitt*, 204 F.3d 683, 690 (6th Cir. 2000).

a. The Powerpoint Presentation Advertising Doors as "Pinch Resistant" Was Not Misleading

The principal advertisement Wayne-Dalton claims was false was contained within a powerpoint presentation Amarr presented to Lowe's. On four different pages of this approximately 65 page

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[2] Unlike a claim for injunctive relief, a claim for damages requires a plaintiff to show actual consumer deception where no literal falsity is shown. Balance Dynamics, 204 F.3d at 690, 693-94.

presentation, Amarr represented that its line of garage doors is "pinch resistant."[3] In a previous opinion, this Court found that the advertisement of Amarr's doors as "pinch resistant" is ambiguous and thus incapable of literal falsity. To obtain the injunctive relief it now seeks, Wayne-Dalton must show that the "advertisement" (to the extent four slides of a powerpoint presentation can be considered an advertisement) is misleading. *Podiatric Physicians*, 185 F.3d at 613. "Consumer reaction is determinative where an advertisement is ambiguous

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[3] Wayne-Dalton attaches to its brief some advertisements Lowe's allegedly published describing the Reliabuilt doors as containing "child-safe finger-protecting door panels." Wayne-Dalton has not, however, sued Lowe's for false advertising as to these advertisements and does not appear to argue that Amarr should be liable for the advertisements of every entity which buys and resells Amarr doors. Instead, Wayne-Dalton's alleged harm is Lowe's decision to purchase Amarr doors instead of Wayne-Dalton doors. Regardless, no causal link can be shown between Lowe's own advertisements and its decision to purchase Amarr's doors where the advertisements were published after Lowe's made its decision. Nor can such after-the-fact evidence illustrate a tendency to deceive Lowe's. Moreover, these advertisements do not alter the Court's conclusion that Amarr's advertisements indicating that its doors were "pinch resistant" meant that they were safer than traditional garage doors with regard to finger/hand pinching, though not necessarily pinch proof. Without evidence or testimony from Lowe's, any link between how Lowe's currently advertises its doors and the meaning Amarr advertisements conveyed in 2006 is speculative at best.

and, hence, only potentially misleading."[4] *Castrol, Inc. v. Pennzoil Co.*, 987 F.2d 939, 947 (3d Cir. 1993).

In support of its claim, Wayne-Dalton submits pictures of a woman inserting the tips of her fingers between the section interfaces of an Amarr garage door. Thus, to succeed on its claim that the advertisement of the doors as "pinch resistant" was misleading, Wayne-Dalton must establish a genuine issue of material fact as to whether "pinch resistant" conveys to customers that the doors will never allow a person to insert the tips of her fingers between the panels of the door. *Podiatric Physicians*, 185 F.3d 606 at 615 n.2 (in deciding if an advertisement is misleading, a court must determine what message the advertisement conveys, and then look to the facts to determine whether a genuine issue exists as to

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[4] The Sixth Circuit's footnote in *Podiatric Physicians* could be interpreted to call for the Court to discern as a matter of law the meaning of an advertisement. *Podiatric Physicians*, 185 F.3d 606 at 615 n2. The Court analogized to contract law, though, in stating that "[w]hether or not a statement is ambiguous would seem to be a question of law, as it is in contract interpretation." *Id.* Several circuits have held that after a court determines that an advertisement is ambiguous, the meaning conveyed becomes a matter of fact. *Clorox Co. v. Proctor & Gamble Commer. Co.*, 228 F.3d 24, 34 (1st Cir. 2000) ("[A] factfinder must determine the claim conveyed by the advertisement."); *Johnson & Johnson v. Smithkline Beecham Corp.*, 960 F.2d 294, 297-98 (2nd Cir. 1992); *Castrol*, 987 F.2d at 947. This is consistent with the Sixth Circuit's analogy to contract law, because determination of whether a contract's language is ambiguous is a matter of law, whereas once a contract has been deemed ambiguous, its meaning becomes a matter of fact. Thus, the Court treats the issue as one of fact, instead of interpreting the Sixth Circuit's footnote in *Podiatric Physicians* to place the circuit in conflict with multiple other circuits. Nevertheless, even if the Court viewed the issue as one of law, its holding would not change because the words "pinch resistant" do not facially convey the meaning "pinch proof."

whether that message is misleading); *U.S. Healthcare, Inc. v. Blue Cross of Greater Phila.*, 898 F.2d 914, 922 (3d Cir.) *cert. denied*, 498 U.S. 816 (1990); *Iams Co. v. Kal Kan Foods*, No. C-3-97-449, 1998 U.S. Dist. LEXIS 19217, at *10 (S.D. Ohio March 31, 1997).

The parties dispute the meaning conveyed by the advertisement of a door as "pinch resistant." Amarr submitted affidavits from certain garage door dealers explaining that they understand pinch resistant to mean a door that is safer than a traditional garage door in terms of reducing the risk that an individual could pinch their fingers between the door's panels. (Doc. No. 30, ¶5, Doc. No. 32, ¶ 5.) In addition, Amarr submitted an entry from Wayne-Dalton's website explaining that a pinch resistant door "is engineered to help eliminate injuries caused when fingers are caught in door panel joints during downward opposition. The shape of the contact point between two door panel sections is designed to push fingers away as the door closes, helping prevent fingers from getting caught in the door joint." (Doc. No. 140, Ex. R.)

Wayne-Dalton repeatedly argued throughout this litigation that "pinch resistant" meant that a door complied with the voluntary standard adopted by the Door and Access Systems Manufacturers' Association ("DASMA") known as DASMA 116. Wayne-Dalton submitted an affidavit from its expert, John E. Scates, claiming that "the industry" has defined a pinch-resistant door as one that passes the DASMA 116 test. (Doc. No. 10, Ex. C.) Scates acknowledged at his deposition, however, that he did not know whether consumers, garage door dealers, or retailers like Lowe's and Home Depot would

believe "pinch resistant" meant that a door complied with DASMA 116. (*Id.* at 25.) In addition, the Court has already articulated in its prior opinion the reasons why "pinch resistant" does not unambiguously convey "DASMA 116 compliant." (Doc. No. 158.) Wayne-Dalton now argues that the "common sense" meaning of pinch resistant is that the doors do not admit fingers. (Doc. No. 174, 3.)

Both parties have declined to obtain discovery from Lowe's, a customer each party seeks to maintain and neither party wishes to involve in this litigation. Without this testimony from Lowe's, the Court is left to discern what the advertisements conveyed to Amarr customers, specifically Lowe's, based upon the testimony of others and the arguments of counsel. Because neither party has produced evidence of how Lowe's (the party whose interpretation would definitely show whether it was misled or deceived by Amarr's representations) interpreted the advertisements, the only evidence of how consumers interpret the "pinch resistant" advertisements is that of the dealers Amarr presented, each of whom understood "pinch resistant" to mean "safer than traditional garage doors with regard to finger and hand pinching." (Doc. No. 30, ¶5, Doc. No. 32, ¶ 5.) Wayne-Dalton's "common sense definition" is undermined by the testimony of its own engineer, who recognized the difference between "pinch proof" and "pinch resistant." (Doc. No. 140, Ex. T at 229.) Thus, the evidence when viewed in a light most favorable to Wayne-Dalton shows that "pinch resistant" conveyed to Amarr customers, such as Lowe's that the doors

were safer than traditional garage doors, but not necessarily pinch proof.[5]

Viewed in a light most favorable to Wayne-Dalton, the evidence in this case shows that the Amarr doors at issue are designed to prevent hand injuries and are less likely to pinch fingers than traditional non-pinch resistant garage doors. (Doc. No. 101, Ex. F; Doc. No. 140, Ex. F at 230; Ex. H at 11-12.) Wayne-Dalton's evidence that a woman, when she intentionally tried to do so, was able to fit the tips of her fingers in between the section interfaces of an Amarr door does not make the advertisements of the doors misleading. Wayne-Dalton's failure to establish a genuine issue of material fact as to whether Amarr's advertisement is misleading provides one distinct basis for rendering summary judgment against Wayne-Dalton on its claim for injunctive relief based upon the "pinch resistant" advertisement.

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[5] This evidence is not surprising, as the difference between "pinch proof" and "pinch resistant" is illustrated when one considers "water resistant" watches. Consumers do not understand watches labeled "water resistant" watches to be incapable of admitting water. Indeed, if such a watch did so, it would be labeled "water proof." Instead, "water resistant" watches are typically those which are more stringent in admitting water than traditional watches. Likewise, the evidence shows that the advertisements that Amarr's doors are "pinch resistant" convey to consumers that the doors are less likely to pinch fingers and hands than traditional doors. Customers, particularly executives from sophisticated parties like Lowe's, reasonably understand how the difference between the two is facially conveyed by the words' plain meaning, and recognize that just because a door is advertised as "pinch resistant" does not mean that it will never pinch a finger, particularly one that someone intentionally inserts between the panels.

a. Wayne-Dalton Has Failed to Show a Tendency to Deceive

In addition to Amarr's powerpoint presentation, Wayne-Dalton also attempts to seek injunctive relief against Amarr for advertisements (1) with pictures that include hands near the seams between two door panels, and (2) that include the phrases "pinch resistant DuraSafe technology," "exceed industry standards," "inspired by little things . . . little hands," and "neither fingers nor weather gets in." Wayne-Dalton's injunctive relief claim based upon all of these advertisements fails, however, because its evidence does not establish that Amarr's advertisements have a tendency to deceive customers.

Regarding the "tendency to deceive" requirement, the Sixth Circuit has made clear that "[a]lthough a plaintiff need not present consumer surveys or testimony demonstrating actual consumer deception, it must present evidence of some sort demonstrating that consumers were misled." *Podiatric Physicians*, 185 F.3d at 618 (evidence of confusion not sufficient to show that consumer was "tricked into believing an untruth about plaintiff"). *See also Herman Miller, Inc. v. Palazzetti Imports and Exports, Inc.*, 270 F.3d 298, 323-24 (6th Cir.

2001) (evidence of possible confusion not sufficient to show tendency to deceive).[6]

Wayne-Dalton attempts to sustain its burden to show a tendency to deceive by submitting evidence that in March of 2006, after Lowe's performed a review of its garage door vendors, it elected to begin selling more Amarr doors instead of Wayne-Dalton doors. Without providing any evidentiary support other than the fact of the presentation itself, Wayne-Dalton alleges that Lowe's made this choice based upon the powerpoint presentation Amarr exhibited to Lowe's. As discussed previously, this approximately 65-page presentation which promoted

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[6] Wayne-Dalton also argues that it offers circumstantial evidence which is sufficient to show a tendency to deceive, and that this evidence should allow the Court to grant summary judgment in Wayne-Dalton's favor. In support of this argument, Wayne-Dalton cites *Max Daetwyler Corp. v. Input Graphics, Inc.*, 608 F. Supp. 1549 (E.D. Penn. 1985). In *Daetwyler*, the court refused to grant summary judgment on the plaintiff's claim for injunctive relief where the plaintiff had failed to submit consumer surveys which proved actual deception. 608 F. Supp. at 1553-54. The court explained that "it may be possible to satisfy a factfinder that consumers have been deceived or are likely to be deceived by means other than a survey." *Id.* at 1553. In addition, the court stated in dicta that "there may be a basis upon which a plaintiff may obtain injunctive relief without presenting any evidence regarding the reactions of consumers to the representations made by the defendant." Whatever the merits of this statement of possibility (notwithstanding the use of the word "may" and the fact that such pontification was not central to the court's holding), the Sixth Circuit has made clear that in a claim for false advertising, even one seeking injunctive relief, "[a]lthough plaintiff need not present consumer surveys or testimony demonstrating actual deception, it must present evidence of some sort demonstrating that consumers were misled." *Podiatric Physicians*, 185 F.3d at 618. Wayne-Dalton has not done so in this case.

numerous reasons Amarr thought Lowe's should choose its doors, Amarr represented on four pages that its entire line of doors were "pinch resistant."[7] (Doc. No. 136, Ex. I at A2685, A2686, A2693, A2708.) In Wayne-Dalton's view, it is reasonable to infer that Lowe's chose to sell more of Amarr's doors instead of Wayne-Dalton's doors based upon the portion of the powerpoint presentation indicating that Amarr's doors were "pinch resistant." Wayne-Dalton's entire theory of all of Amarr's advertisements' tendency to deceive rests upon this inference. Wayne-Dalton does not offer any evidence that any of the other Amarr advertisements (those other than the powerpoint presentation) deceived Lowe's into purchasing Amarr's doors. It does not offer any testimony that Lowe's used any of the advertisements as a basis upon which it decided to use Amarr doors. Nor does it offer any evidence that anyone from Lowe's ever even saw these advertisements. It bases its entire argument regarding the tendency of Amarr's advertisements to deceive customers upon the temporal proximity of the powerpoint presentation to Lowe's decision to sell more Amarr doors instead of Wayne-Dalton

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[7] It should be noted that while Wayne-Dalton now relies upon this evidence to show a tendency to deceive, it did not argue at summary judgment regarding its claim for damages that such evidence illustrated the actual consumer deception required to sustain a claim for damages based upon false advertising. Wayne-Dalton's position then was that it need not show any deception because it had proved literal falsity. Additionally, Wayne-Dalton did not argue in response to Amarr's motion for summary judgment that it had sufficient evidence of actual deception to sustain a prima facie case. Nor did it do so in its motion for reconsideration. Its position was that it did not have to show such evidence. The Court rejected Wayne-Dalton's position and found that it was required to show actual deception, and because it had not offered any such evidence, summary judgment was warranted.

doors. Thus, as an initial matter, any claim based upon the advertisements other than the powerpoint presentation must fail for lack of any proof of tendency to deceive.

Additionally, the Court finds that Wayne-Dalton has failed to carry its burden with regard to the powerpoint presentation. The Sixth Circuit distinguishes the requirement of showing a tendency to deceive when seeking injunctive relief from the actual consumer deception that must be shown to recover damages for false advertising. This distinction recognizes that evidence of actual consumer deception is often difficult to obtain, and may require elaborate consumer surveys that may or may not suffice. *See Balance Dynamics*, 204 F.3d at 692; *Johnson & Johnson-Merck Consumer Pharm. Co. v. Rhone-Poulenc Rorer Pharm., Inc.*, 19 F.3d 125, 137 (3d Cir. 1994). In this case, however, consumer reaction evidence would not be difficult to obtain. The sole customer that Wayne-Dalton alleges was deceived is Lowe's, a current customer of both parties that surely was available to provide discovery. Wayne-Dalton chose not to submit any evidence of how any Lowe's personnel viewed the advertisement or whether they were "tricked into believing an untruth" by the advertisements. Without this evidence, the only direct evidence in the record of how any consumers interpreted the "pinch resistant" advertisements is that of the dealers Amarr presented who understand "pinch resistant" to mean "safer than traditional garage doors with regard to finger and hand pinching." Thus, contrary to Wayne-Dalton's position, the record does not support the conclusion that Lowe's was deceived by the advertisements. (Doc. No. 30, ¶5; Doc. No. 32, ¶ 5.)

Despite the complete lack of direct evidence, Wayne-Dalton argues that the tendency of the advertisements to deceive is illustrated by Lowe's decision to purchase more of Amarr's doors following Amarr's powerpoint presentation advertising them as "pinch resistant." While using broad language in describing the requirement as merely showing a "tendency to deceive," the Sixth Circuit has nevertheless been skeptical of such claims when they are based on highly speculative evidence of alleged tendency to deceive.

In *Miller*, 270 F.3d at 323, Herman Miller, a furniture company, sued Palazzetti Imports and Exports, another furniture company, claiming in part that Palazzetti's advertisement of its chairs was misleading and could cause customers to believe Palazzetti was offering original chairs produced by Herman Miller. Herman Miller produced evidence of two customer letters to Palazzetti referring to the chairs by the Herman Miller's chair's name, and testimony of a Herman Miller employee who was asked by a customer whether Herman Miller's chair was the same as one the customer had seen in Palazzetti's showroom. *Id.* The district court granted judgment as a matter of law on the false advertising claims due to lack of evidence of deception or tendency to deceive, and the Sixth Circuit affirmed. The court explained that, where the evidence gave no indication whether the consumers thought they had actually purchased original items rather than reproductions, the evidence, at best, showed some confusion among three customers but failed to show that consumers were actually deceived by the advertising or that the advertisements had a tendency to deceive consumers. *Id.* at 323-34. *See also Podiatric Physicians*, 185 F.3d at 618 (affirming

district court's denial of injunctive relief because, although letters suggesting confusion provided "some evidence of deception generally, [the evidence] does little to prove that [. . .] the entities plantiffs claims are its Lanham Act consumers were deceived by the [defendant's] statements"). The Sixth Circuit's decisions make clear that courts should avoid enjoining parties from advertising their products merely because they used ambiguous language where the evidence does not show that such language has a tendency to deceive consumers. *See Miller*, 270 F.3d at 323; *Podiatric Physicians*, 185 F.3d at 618.

As in *Podiatric Physicians* and *Miller*, the Court finds that Wayne-Dalton's evidence does not show that Amarr's advertisements tended to deceive Lowe's or any other customer into purchasing Amarr doors. In fact, the record is replete with evidence of Lowe's dissatisfaction with Wayne-Dalton's poor customer service (Doc. No. 105, Exs. 1, 3, 5, 7, 9, 12, 13, 16, 17, 20, 22, 24, 25, 26, 27, 28, 30, 31, 32, 33, 34, 35, 36 [8], 38 [9], 39 [10], 41, 44, 45 [11], 47 [12]) and

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[8] In this e-mail, a Lowe's area installation manager wrote "we are having a lot of problems . . . with Wayne-Dalton and that is the main reason sales are down. I explained the situations we are running into with Wayne Dalton and their lack of good customer service."

[9] In this e-mail, one Wayne-Dalton executive tells another "It is obvious that Lowes could care less [sic] about differet ion [sic] of product – they cannot sell [. . .] pinch resistance or free foam stop. We must begin to think based on what Lowes [sic] is doing or the direction they are headed vs. where we have been."

[10] In this e-mail, Wayne-Dalton's president wrote regarding Lowe's decision following the line review that he thought Lowe's blamed Wayne-Dalton and Holmes, another garage door manufacturer, for the poor reaction to Lowe's installation

admissions of Wayne-Dalton executives indicating that Lowe's chose to increase Amarr sales instead of Wayne-Dalton sales due to Amarr's better capabilities to perform certain types of installations. (Doc. No. 140, Ex. C at 102-03; Doc. No. 105, Ex. 39.) This transforms what is, in isolation, a very weak inference of a tendency to deceive supported by highly circumstantial evidence into a wholly unreasonable one. Placed in proper context, Lowe's decision to purchase more Amarr doors in lieu of Wayne-Dalton doors is explained fully by factors unrelated to the allegedly deceptive advertising. Under the circumstances, any inference that Lowe's was somehow deceived into choosing Amarr doors over Wayne-Dalton doors based solely on the temporal proximity of Amarr's presentation with Lowe's decision to buy the doors is wholly speculative and unreasonable.[13]

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programs, and that "the only program that looked good or carried no scars was Amarr" which offered advantages to its installations over Wayne-Dalton's.

[11] This exhibit is an e-mail from Lowe's merchandise director telling Wayne-Dalton executives, "I am seeing an [sic] large disparity in the level of service between WD and other vendors that provide a more dense coverage [of territory managers]."

[12] This exhibit is an e-mail from a Wayne-Dalton executive explaining, "Lowes cited the Amarr install lead times as one of the reasons they were switching to them."

[13] Indeed, even if Lowe's chose to buy the doors because they were advertised as pinch resistant, Wayne-Dalton has presented no evidence that Lowe's understood pinch resistant to mean the doors would not allow a person to intentionally insert a fingertip between the door's sections.

Because Wayne-Dalton does not offer even a mere scintilla of evidence of the tendency of Amarr's advertisements to deceive Lowe's or any other consumer, none of the advertisements provide the basis for granting Wayne-Dalton injunctive relief. *Podiatric Physicians*, 185 F.3d at 618. *See also Pizza Hut v. Papa John's Int'l*, 227 F.3d 489, 503-04 (5th Cir. 2000) ("To prove a tendency to deceive, plaintiffs need to show that at least some consumers were confused by the advertisements.").

1. Equitable Considerations Do Not Warrant a Permanent Injunction

Beyond failing to show success upon the merits, the Court also finds that Wayne-Dalton has not shown that the Court should exercise its equitable discretion to issue a permanent injunction. After Wayne-Dalton filed this lawsuit, it issued press releases detailing its claims of false advertising. It sent them to Amarr customers, and posted them on its website. In addition, a Wayne-Dalton representative met with a representative of Lowe's. Despite this publicity surrounding Wayne-Dalton's allegations that Lowe's was deceived by Amarr's advertisements, Lowe's has continued to purchase and resell Amarr's doors. Meanwhile, Amarr has told its dealers and customers to cease advertising its doors as "pinch resistant" so as to avoid further litigation. Where Amarr has voluntarily ceased the attacked advertisement, the Court finds that a remedy at equity is unwarranted. *See Iams Co. v. Nutro Prods.*, No. 3:00CV566, 2004 U.S. Dist. LEXIS 15134 at *17-18 (S.D. Ohio July 3, 2004) ("Equity will not enjoin conduct which has been voluntarily terminated and where there is no threat of resumption."). Indeed, although Amarr has long

since stopped advertising its doors as pinch resistant and Wayne-Dalton notified Lowe's of the alleged false advertising, Lowe's continues to purchase Amarr's doors. This fact undermines the argument that Lowe's continues to be deceived by Amarr's allegedly false advertising, such that Wayne-Dalton continues to suffer an injury which cannot be compensated by damages if Wayne-Dalton adequately proved such a claim. Further, although Wayne-Dalton demands an injunction ordering Amarr to send out notices to all of its customers that its doors may fail the DASMA 116 standard (a standard both the Court and DASMA previously recognized as ambiguous), DASMA amended, or at least clarified, the DASMA 116 standard after Amarr last advertised its doors as pinch resistant. Thus, any injunctive relief requiring corrective advertising regarding DASMA 116 would be confusing and would not serve the purposes of equity. Thus, Wayne-Dalton has not shown that a permanent injunction is warranted in this case.

IV. CONCLUSION

For the foregoing reasons, Amarr's brief in opposition to Wayne-Dalton's requests for permanent injunctive relief (Doc. No. 171), construed as a motion for summary judgment, is hereby **GRANTED**. Wayne-Dalton's brief on injunctive relief (Doc. No. 172), construed as a motion for summary judgment, is **DENIED**.[14]

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[14] In a judgment entry filed contemporaneously with this memorandum opinion and order, the Court enters final judgment on the claim for false advertising and certifies the issue for appeal.

IT IS SO ORDERED.

Dated: August 14, 2008

/s/ Sara Lioi

UNITED STATES DISTRICT JUDGE

[Entered: August 14, 2008]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

WAYNE DALTON CORP., PLAINTIFF,	)	CASE NO. 5:06CV01768
	)	JUDGE SARA LIOI
vs.	)	JUDGMENT ENTRY
AMARR COMPANY, DEFENDANT.	)	

For the reasons set forth in the Memorandum Opinions filed on January 23, 2008 (Doc. No. 156), April 28, 2008 (Doc. No. 168), and contemporaneously with this Judgment Entry (Doc. No. 183), it is hereby **ORDERED, ADJUDGED** and **DECREED** that Defendant's Motions for Summary Judgment (Doc. Nos. 128 and 171) regarding Wayne-Dalton's claims for damages and injunctive relief due to alleged false advertising are **GRANTED**.

Having completely resolved the entire claim for false advertising (and stayed the patent portion of this case pending resolution of the reexamination proceedings before the United States Patent and Trademark Office), pursuant to Fed. R. Civ. P. 54(b)

the Court finds that there is no just reason for delay and enters final judgment on this claim.[1]

IT IS SO ORDERED.

Dated: August 14, 2008

/s/ Sara Lioi

UNITED STATES DISTRICT JUDGE

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[1] The Court bases its finding upon consideration of a number of factors. *See Akers v. Alvey*, 338 F.3d 491, 495 (6th Cir. 2003) (calling for some analysis prior to rendering an order final and appealable). First, the two claims are factually and legally independent and distinct. Second, if the initial holding of the PTO that Wayne-Dalton's patent is invalid is ultimately upheld, the patent portion of this case will cease. Third, Wayne-Dalton's false advertising claim should not be delayed solely because the PTO proceedings are ongoing regarding Wayne-Dalton's patent. *See Pittman v. Franklin*, No. 07-5376, 2008 U.S. App. LEXIS 13563, at *32-33 (6th Cir. June 24, 2008).

[Entered: April 29, 2008]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

WAYNE DALTON CORP., PLAINTIFF,	)	CASE NO. 5:06CV01768
	)	JUDGE SARA LIOI
vs.	)	MEMORANDUM OPINION AND ORDER
AMARR COMPANY, DEFENDANT.	)	

This matter comes before the Court upon the motion of Plaintiff Wayne-Dalton Corp. ("Wayne-Dalton") for reconsideration of the Court's January 23, 2008, opinion granting Defendant Amarr Company ("Amarr")'s motion for summary judgment as to Wayne-Dalton's ability to recover damages on its false advertising claim. (Doc. No. 156.) For the reasons that follow, Wayne-Dalton's motion for reconsideration is hereby **DENIED**.

I. FACTUAL AND PROCEDURAL BACKGROUND

The facts surrounding this case are set forth in the Court's January 23, 2008 Memorandum Opinion and Order, and will not be reiterated in detail herein. Wayne-Dalton and Amarr both

manufacture garage doors. Both are members of the Door and Access Systems Manufacturers Association ("DASMA"). DASMA adopts voluntary safety standards "as a guide to aid the manufacturer, the consumer and the general public." (Standard for Section Interfaces on Residential Garage Door Systems, Doc. 134, Ex. C, Ex. 2.) One such standard, DASMA 116, attempts to test whether a garage door is "pinch resistant" by testing whether a "finger probe" is likely to be pinched by the garage door as the door moves on its track.

Wayne-Dalton brought a claim for false advertisement in violation of 15 U.S.C. § 1125. Wayne-Dalton contended that Amarr falsely advertised Amarr's doors as "pinch resistant." The Court granted Amarr's motion for summary judgment on Wayne-Dalton's claim for damages because Wayne-Dalton failed to offer any evidence of actual consumer deception and because the claim was barred by the doctrine of laches. Wayne-Dalton argued that it was not required to provide such evidence of actual deception because Amarr's advertisements, in Wayne-Dalton's view, were

literally false.[1] The Court found, pursuant to prevailing Sixth Circuit authority, that claiming the doors were "pinch resistant" was ambiguous as a matter of law, and, therefore, incapable of literal falsity. Accordingly, because Wayne-Dalton admitted that it had no evidence of actual consumer deception, the Court granted Amarr's motion for summary judgment on Wayne-Dalton's ability to recover damages for false advertising. The Court also found that Wayne-Dalton had constructive knowledge of the alleged false advertising over two years prior to filing suit and could not sustain the accompanying burden of persuading the Court that laches did not bar the claim. Wayne-Dalton now moves for reconsideration of the Court's decision.

II. STANDARD OF REVIEW

The Federal Rules of Civil Procedure do not provide for motions for reconsideration. Nonetheless, district courts have "inherent powers to reconsider interlocutory orders and reopen a part of a case before entry of a final judgment." *Mallory v. Eyrich*, 922 F.2d 1273, 1282 (6th Cir. 1991). Motions for reconsideration are not substitutes for appeals nor

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[1] The Court notes that, even if the Court had found that Amarr's advertisements were capable of literal falsity, it is not at all clear that Wayne-Dalton would be able to defeat summary judgment on its claim for damages. *See Balance Dynamics Corp. v. Schmitt Industries*, 204 F.3d 683, 694 (6th Cir. 2000) (rejecting claim for marketplace damages based purely on literal falsity of advertisement and explaining that "[t]he 'literal falsity' rule has never permitted a plaintiff to recover marketplace damages without other proof that such damages occurred").

are they vehicles whereby a party may present arguments inexcusably omitted in prior proceedings. *Karr v. Castle*, 768 F. Supp. 1087, 1093 (D. Del. 1991), *citing Brambles U.S.A., Inc. v. Blocker*, 735 F. Supp. 1239, 1240-41 (D. Del. 1990). "The major grounds justifying reconsideration of interlocutory orders are an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent manifest injustice." *Reich v. Hall Holding Co.*, 990 F. Supp. 955, 965 (N.D. Ohio 1998), *citing Petition of United States Steel Corp.*, 479 F.2d 489, 494 (6th Cir. 1973). The motion for reconsideration must demonstrate to the Court why it should reconsider its decision and set forth strongly convincing facts or law which would induce it to reverse its prior holding. *Shields v. Shetler*, 120 F.R.D. 123, 126 (D. Colo. 1988). A motion for reconsideration that presents no arguments that have not already been raised should be denied. *See Backlund v. Barnhart*, 778 F.2d 1386, 1388 (9th Cir. 1985); *Cover v. Wal-Mart Stores, Inc.*, 148 F.R.D. 294, 295 (M.D. Fla. 1993).

III. LAW AND ANALYSIS

Wayne-Dalton first argues that the Court misconstrued its argument as to the meaning of "pinch resistant." Wayne-Dalton now claims that DASMA 116 "is not the advertising phrase in issue, but merely a tool that the trier of fact can use to determine whether the term 'pinch resistant' is literally false." (Mot. for Recons. 4.) Wayne-Dalton's repeated references to "pinch-resistant" meaning "DASMA 116-compliant" throughout this litigation belie any such assertion. These references are well

documented in Amarr's opposition to the motion for reconsideration (Doc. No. 161), but the Court specifically notes some of the particularly clear examples:

1. Wayne-Dalton's complaint alleges that Amarr's advertisement "communicates to consumers that at least the 'Weatherguard,' 'Classica,' 'Heritage,' and 'Stratford' brand garage doors made and sold by Amarr, and the 'private label' garage doors made by Amarr and sold by others, comply with Standard 116 of DASMA relating to pinch-resistant construction." (Doc. No. 1, ¶ 24.)

2. Wayne-Dalton's memorandum in support of its motion for preliminary injunction states, "In a society that has become increasingly safety conscious, the demand for pinch resistant doors, or those complying with DASMA 116, have increased significantly." (Doc. No. 10, 3.)

3. Wayne-Dalton's memorandum in support of its motion for preliminary injunction also explains, "John Scates, a member of the Technical Committee that developed DASMA Standard 116 (Scates Declaration, Par. 5), sets forth in his Declaration with attached exhibits, the requirements for a garage door to be considered "pinch resistant"

and thereby to be one that "conforms to the requirements of DASMA 116." (*Id.* at 15.)

4. Wayne-Dalton's motion for summary judgment claims, "DASMA 116 sets out the standard for a 'pinch resistant' garage door." (Ptf.'s Mot. for Summ. J., 5.)

Indeed, Wayne-Dalton submitted multiple affidavits to support its claim that "pinch resistant" means DASMA 116-compliant. *See* (Bennett Dec., Doc. No. 10, ¶ 14); (Scates Dec., Doc. No. 10, ¶ 6.) Wayne-Dalton repeatedly argued that a trier of fact could discern that Amarr's doors were not pinch resistant because they allegedly failed to comply with DASMA 116. It now argues that it can remedy the ambiguity in the term "pinch resistant" by withdrawing the only definition it offered for the phrase. Such after-the-fact arguments are not appropriate for a motion for reconsideration, and, again, are belied by Wayne-Dalton's repeated insistence that pinch resistance equated to DASMA 116 compliance. Accordingly, the Court finds Wayne-Dalton's claim that the Court misconstrued its argument unpersuasive.

Wayne-Dalton also argues that the Court should have left the determination of the clarity of "pinch resistant" to a jury. Wayne-Dalton argues that the "term 'pinch resistant' has a connotation of its own that is capable of determination by a jury," and on that basis the Court should have denied Amarr's motion for summary judgment. (Doc. 164, 2.) It similarly argues that the Court should reconsider its decision because the issue of whether DASMA 116 is ambiguous is one for the jury. These arguments disregard Sixth Circuit precedent which explains that, in analyzing a false advertising claim, a Court must first determine whether the statements at issue *may be* determined literally false before submitting them to the factfinder to determine whether they *are* literally false in light of the facts of the case. *See Podiatric Physicians*, 185 F.3d at 615 n.2 ("[T]he initial determination concerning whether a statement is ambiguous is a matter of law, while the determination as to whether facts exist so as to justify the statement is a question of fact."). The question of the ambiguity of the statements is one of law, for the Court to decide. This Court thus performed its judicial duty -- deciding matters of law -- when it found that the statements at issue in this case and DASMA 116 itself, like the many statements found ambiguous in *Podiatric Physicians*, are ambiguous as a matter of law. *See Podiatric Physicians*, 185 F.3d at 616 (finding ambiguous the claim that a medical board is "professionally recognized" and asking, "To be 'professionally recognized,' must the [board] be

recognized by most podiatrists? Most people in the medical profession? Some podiatrists?").[2]

Wayne-Dalton also offers the newly adopted DASMA standard as new evidence that should, in its view, warrant the Court's reconsideration of the summary judgment decision. DASMA has apparently preliminarily adopted a new DASMA 116 standard. This new standard includes a clarification of what it means to "admit" a finger probe into the pinch point areas between the section interfaces of a garage door. The definition of "admit" also clarifies, via a convenient graphic illustration, the reference plane to be used when conducting the test. This new evidence only further supports the Court's conclusion that the prior DASMA 116 test, to which

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[2] Indeed, as Wayne-Dalton appears to now concede that "pinch resistant" does not necessarily mean "DASMA 116-compliant," it is not clear how a jury could determine whether a door was literally "pinch resistant." What does it mean to "resist" pinching? Must a door "resist" pinching both adults' fingers and childrens' fingers? Only fingers but not shirt sleeves? Is the door "pinch resistant" because it avoids *being* pinched due to its flat panels? Wayne-Dalton has no answer for these questions and instead believes that the Court must leave the issue for the jury to discern. This claim disregards the Sixth Circuit's approach to literal falsity in *Podiatric Physicians*, and fails as a matter of law.

Amarr's doors were to be subjected under Wayne-Dalton's claim, was ambiguous.[3]

Accordingly, the Court finds that its prior decision granting summary judgment due to a lack of evidence of actual consumer deception was not a manifest injustice or clear error. Indeed, it was compelled by an extensive review of the briefs, the evidence of record, and the relevant case law.[4]

Wayne-Dalton also argues for reconsideration because the Court issued its decision on the motions for summary judgment prior to holding the oral argument the Court had scheduled. The Court did originally schedule an oral argument on the motion for summary judgment regarding Amarr's laches

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[3] Wayne-Dalton also argues that new evidence in the record, a lawsuit filed in New York alleging that a woman's fingers were injured by a door made by Amarr, warrants reconsideration by this Court. Nothing has been proven in that suit yet, and even if it was proven, it does nothing to advance Wayne-Dalton's claims in this case.

[4] Even after Wayne-Dalton has had two more bites at the proverbial apple via its motion for reconsideration and reply (in which it has now attempted to retreat from the argument it made consistently throughout this litigation that a door's pinch resistance is measured by its compliance with DASMA 116), it still has yet to provide a clear definition for "pinch resistant." Merely arguing that the Court should view the "entire mosaic" of Amarr's advertisements with no regard for whether such advertisements convey a clear message capable of an objective determination of literal falsity is insufficient under Sixth Circuit precedent. See Podiatric Physicians, 185 F.3d at 614-616 (evaluating each individual statement in a letter to determine whether it is capable of actual falsity and requiring evidence of actual deception where even one clause of a sentence was ambiguous).

argument (Minutes of October 10, 2007 telephone conference), and then rescheduled it to address all of the pending motions for summary judgment. (Doc. Nos. 135 & 152.)

Local Rule 7.2(b) provides, "In those cases in which a summary judgment motion is pending, the Judicial Officer may consider scheduling the case for oral argument." The rule provides the Court with appropriate discretion to hear or not hear oral argument regarding dispositive motions. *See also Schentur v. United* States, 1993 U.S. App. LEXIS 22060, at *15 (6th Cir. 1993) (affirming that "district courts may dispense with oral argument on motions for any number of sound judicial reasons"); *Yamaha Corp. v. Stonecipher's Baldwin*, 975 F.2d 300 (6th Cir. 1992) (the Federal Rules of Civil Procedure and Sixth Circuit precedent support the legitimacy of local rules that vest courts with discretion regarding oral argument on dispositive motions).

In its discretion, the Court chose to forego the benefit of oral argument and decide the motions upon the briefs themselves. Notably, the scheduled event was an oral argument, not an evidentiary hearing or other opportunity to submit evidence other than what had already been provided in the nine (9) briefs the parties submitted regarding summary judgment on the false advertising claim (in addition to the three (3) previously filed briefs regarding Wayne-Dalton's motion for a preliminary injunction). The Court acknowledges that it could have explicitly stated in its Memorandum Opinion and Order that it had chosen to decide the motions without the benefit of oral argument. The Court was

not, however, required to do so. In addition, Wayne-Dalton could not possibly have "relied upon" the scheduling of the argument, as it claims, because it was able to exhaustively brief the issues and submit all of its evidence regarding the false advertising claim.[5] Nor, as Wayne-Dalton contends without any authority to support its argument, is holding an oral argument required in order to allow Wayne-Dalton to "perfect the record for appeal." Wayne-Dalton was given the opportunity to, and in fact did, make over 100 pages of argument on this single cause of action prior to the Court rendering its summary judgment opinion.[6] The oral argument was scheduled merely as a benefit to the Court should it, in its discretion, decide to hear such argument. Accordingly, the Court finds Wayne-Dalton's argument unavailing.

Finally, Wayne-Dalton argues that the Court should reconsider its decision that the false advertising claim is also precluded by the doctrine of

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[5] Wayne-Dalton submitted each of the following briefs with evidence and argument on the motions for summary judgment regarding the false advertising claim: Opposition to motion for summary judgment (Doc. No. 58); Motion for summary judgment on the issue of Amarr's liability for literal false advertising (Doc. No. 134); Opposition to motion for summary judgment (Doc. No. 139); and Reply (Doc. No. 146). These were in addition to Wayne-Dalton's two briefs with evidence regarding its motion for a preliminary injunction. *See* Brief in Support of Motion for preliminary injunction (Doc. No. 10); Reply brief to Amarr's brief in opposition to plaintiff's motion for preliminary injunction (Doc. No. 42).

[6] The Court again reiterates that it scheduled an oral argument, not an evidentiary hearing, so Wayne-Dalton knew it would not be permitted to submit further evidence into the record at the oral argument.

laches. The Court found that Wayne-Dalton had constructive knowledge of the alleged false advertising over two years prior to filing this suit, and could not overcome the presumption that laches barred its claim. Wayne-Dalton makes the same two arguments in the motion for reconsideration that the Court rejected in its summary judgment opinion.[7] Because Wayne-Dalton simply rehashes arguments the Court previously rejected, denial of the motion for reconsideration on this ground is appropriate. *See Backlund*, 778 F.2d at 1388; *Cover*, 148 F.R.D. at 295. The evidence Wayne-Dalton cites in support of its motion for reconsideration was considered in the Court's January 23, 2008 Memorandum Opinion and Order, so it is not "new evidence" which would warrant reconsideration. Wayne-Dalton also has not

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[7] Wayne-Dalton first claims that it had no actual knowledge of Amarr's false advertising prior to July of 2004. This argument, as the Court explained in the January 23, 2008 Memorandum Opinion and Order disregards the fact that constructive knowledge may support a finding of laches. *See Nartron Corp. v. ST Microelectronics Inc.*, 305 F.3d 397, 408 (6th Cir. 2002). *See also Comerica Bank v. Suburban Trust & Sav. Bank*, No. 95-1551, 1996 U.S. App. LEXIS 26778, *20 (6th Cir. Oct. 10, 1996) (Constructive knowledge is "imputed when one by exercise of reasonable care would have known a fact."). Wayne-Dalton's second argument is that Amarr changed the design of its doors between 1999, when Wayne-Dalton had first found Amarr's doors in compliance with DASMA 116, and 2005, when Wayne-Dalton allegedly learned for the first time of the false advertising. According to Wayne-Dalton, this alleged change provides an excuse for failing to timely bring suit. The evidence Wayne-Dalton cites to support this argument is an Amarr advertisement with a copyright date of 2003, which does nothing to aid Wayne-Dalton's argument that it did not have constructive knowledge prior to July of 2004. Thus, as it did in its summary judgment opinion, the Court finds Wayne-Dalton's argument unpersuasive.

shown that the Court's decision was a manifest injustice or clear error. It has thus failed to show that this Court should reconsider its prior decision.

IV. CONCLUSION

Ultimately, Wayne-Dalton failed to secure evidence of actual consumer deception to support its false advertising claim, and it exhibited an inequitable delay in bringing the claim. It has not demonstrated to the Court that the January 23, 2008 decision should be altered. As such, Wayne-Dalton's motion for reconsideration (Doc. No. 157) is hereby **DENIED**.

Dated: April 29, 2008

/s/ Sara Lioi

UNITED STATES DISTRICT JUDGE

[Entered: January 23, 2008]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

WAYNE DALTON CORP., PLAINTIFF,	)	CASE NO. 5:06CV01768
	)	JUDGE SARA LIOI
vs.	)	MEMORANDUM OPINION AND ORDER
AMARR COMPANY, DEFENDANT.	)	

This matter came before the Court upon multiple motions for summary judgment, as follows:

(1) The motion of Defendant Amarr Company ("Amarr") for summary judgment as to the false advertising claim asserted by Plaintiff Wayne-Dalton Corp. ("Wayne-Dalton") (Doc. No. 48);

(2) Wayne-Dalton's cross-motion for summary judgment on the issue of the literal falsity of Amarr's advertisements (Doc. No. 134);

(3) Amarr's motion for summary judgment as to Wayne-Dalton's ability to recover damages for its false advertising claim (Doc. No. 128);

(4) Wayne-Dalton's motion for summary judgment on the issue of patent infringement (Doc. No. 126);

(5) Amarr's motion for summary judgment on the issue of patent infringement (Doc. No. 131); and

(6) Amarr's motion to stay the patent infringement claim pending the outcome of the PTO reexamination proceeding (Doc. No. 149).

Upon review of the memoranda and evidence submitted, the Court finds as follows:

(1) Amarr's Motion for Summary Judgment on the False Advertising claim is GRANTED, in part;

(2) Amarr's motion for Summary Judgment on Wayne-Dalton's inability to recover damages for its false advertising claim is GRANTED;

(3) Wayne-Dalton's Motion for Summary Judgment as to literal falsity is DENIED;

(4) Amarr's motion to stay the patent infringement claim is GRANTED; and

(5) Both parties' motions for summary judgment as to the patent infringement claim are DENIED WITHOUT PREJUDICE.

I. Factual and Procedural Background

Wayne-Dalton and Amarr both manufacture garage doors. Both are members of the Door and Access Systems Manufacturers Association ("DASMA"). DASMA adopts voluntary safety standards "as a guide to aid the manufacturer, the consumer and the general public." (Standard for Section Interfaces on Residential Garage Door Systems, Doc. 134, Ex. C, Ex. 2.) One such standard, DASMA 116, attempts to test whether a garage door is "pinch resistant."

Typically, when garage doors open and close, the section "interfaces" of the door rest together when the door is in either the vertical closed position or the horizontal open position, but separate from one another during the process of opening and closing due to the rounded turn. In the late 1990s, garage door manufacturers, including Wayne-Dalton and Amarr, researched ways to minimize the possibility of an individual's fingers becoming pinched between the interfaces of a garage door when those interfaces came apart and then together during the door's opening and closing. This research resulted, generally, in placing the interfaces closer together during angular articulation, such that fingers normally could not fit between the interfaces. Thereafter, Amarr and Wayne-Dalton began advertising their doors as "pinch-resistant."

Manufacturers seeking to mimimize finger pinching were faced with the challenge, though, of doing so while also avoiding the binding and popping that occurred when garage door panels were designed in a way which held them together without

any clearance between the panels during opening and closing the door. One solution manufacturers discovered was to offset the center hinges from the side hinges of the door.

Wayne-Dalton owns a patent to a sectional door with such offset hinges (although it does not manufacture a door using the patented technology), and it has brought this suit claiming that Amarr's WeatherGuard Plus door infringes its patent. Amarr maintains that its doors do not infringe Wayne-Dalton's patent, and that Wayne-Dalton's patent is invalid.

The Court held a *Markman* hearing on July 12, 2007, and then issued an opinion regarding the construction of the patent's claims. Further discovery was exchanged between the parties and the motions for summary judgment at issue were filed. During this period of time, the United States Patent Office ("PTO") granted Amarr's request for a reexamination of Wayne-Dalton's patent. The PTO has communicated its initial position that the claims at issue in this case are invalid. Amarr has since moved to stay Wayne-Dalton's patent claim in this Court pending the outcome of the PTO proceeding. Wayne-Dalton also asserts a separate claim that Amarr has falsely advertised its popular garage door models, including the WeatherGuard Plus, the Heritage, the Stratford, and the Classica doors, as "pinch-resistant" when they do not meet DASMA's alleged standard for pinch resistance. (Complaint, Doc. No. 1, 4.)

II. Law & Analysis

A. Standard of Review

This Court's consideration of the motion for summary judgment is governed by Rule 56 of the Federal Rules of Civil Procedure:

> (c) The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.

Id. The party opposing a motion for summary judgment made according to Rule 56 "may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e).

In reviewing summary judgment motions, this Court must view the evidence in a light most favorable to the non-moving party to determine whether a genuine issue of material fact exists. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144 (1970); *White v. Turfway Park Racing Ass'n*, 909 F.2d 941, 943-44 (6th Cir. 1990). A fact is "material" only if its resolution will affect the outcome of the lawsuit. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). Determination of whether a factual issue is "genuine" requires consideration of the applicable

evidentiary standards. Thus, in most cases the Court must decide "whether reasonable jurors could find by a preponderance of the evidence that the [non-moving party] is entitled to a verdict." *Id.* at 252. Moreover, the non-movant must show more than a scintilla of evidence to overcome summary judgment. *Id.* In light of this standard, the Court considers the dispositive motions.

B. Choice of Law

Federal Circuit law applies to Wayne-Dalton's claim for patent infringement, while Sixth Circuit law applies to its claim for false advertising. *Optivus Tech., Inc. v. Ion Beam Applications*, 469 F.3d 978, 984 (Fed Cir. 2002) (applying law of the regional circuit in which the district court sits where the claim is not unique to the Federal Circuit's exclusive jurisdiction).

C. Lanham Act Claims

In its claim for false advertising, Wayne-Dalton alleges that Amarr falsely described its doors as "pinch resistant." According to Wayne-Dalton, "pinch resistant" means that a door complies with DASMA 116, a standard which calls for doors to either contain suitable handles or comply with certain tests to illustrate that a "finger probe" is

unlikely to be pinched by the garage door as it moves on its track.[1] In support of its position, Wayne-Dalton notes that DASMA's website claims that "A door qualifying as 'pinch resistant' is a door that conforms to the requirements of DASMA 116." (Doc. No. 134, Ex. C., Ex. 3.)

In response, Amarr has presented evidence that garage door dealers and consumers, Amarr's customers, do not understand "pinch-resistant" to

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[1] The DASMA test to be conducted, if the door lacks adequate handles, requires one to first "insert" the finger probe beyond a depth of .25 inches. Insertion is defined as "a minimum of .25 inches oriented as shown in Figure 1, moving the finger joints through their full range of articulations." Figure 1 fails to show what reference plane should be used to determine whether a finger probe has been inserted .25 inches. If the probe can be inserted beyond that depth, however, "the area(s) shall be subject to testing in Section 6.2. Section 6.2.2 then explains

> If the area(s) identified by [the finger probe] admits the full diameter of both Probe #2a [a metal rod measuring 0.35 inches in diameter] and Probe #2b [a metal rod measuring 1 inch in diameter], or rejects both Probe #2a and Probe #2b, at the position and orientation identified by [the finger probe], such area(s) shall be deemed compliant with this section and no further testing is required.

Thus, if the "area(s) identified" by the finger probe admit(s) or reject(s) only one of Probe #2a and #2b, but not the other, then the area is subject to the testing in Section 6.3. Section 6.3 requires a tester to hold different probes ranging from 3/8 inch to 1 inch in diameter in the area defined by the finger probe, and move the door into a position where the probe is most difficult to remove. The tester must then determine, using a pull force scale, the amount of force required to remove each probe. If the force required to remove each probe is more than 35 pounds, then the interface fails the test.

mean "complies with DASMA 116." This is supported by the fact that most consumers are unaware of the standards established by the manufacturers' association. (Declaration of Michael Miller, Doc. No. 32, ¶ 5; Declaration of Tony Price, Doc. No. 30, at ¶ 5.) Additionally, the Court notes that the definition of pinch resistant set forth in the patent differs from the DASMA 116 standard,[2] and the patent makes no reference to DASMA 116 (or to any provision of DASMA for that matter). (Doc. No. 142, Ex. 1, cl2, ln10-15.) Further, Wayne-Dalton tested Amarr's doors in 1999 and believed they complied with DASMA 116, but now Wayne-Dalton asserts that Amarr's doors do not meet the standard.

Even if DASMA 116 does control, the parties disagree as to the standard called for by DASMA 116. The dispute centers around what reference plane should be used when determining whether a probe is "admitted" or "rejected." Tellingly, DASMA has recently investigated the possibility of clarifying the DASMA 116 standard,[2] and a proposal which would include a graphic illustration of the reference plane to be used is currently under consideration.

i. Lack of Proof of Actual Deception

Wayne-Dalton's claim for false advertising arises under 15 U.S.C. § 1125, enacted as part of the Lanham Act. The statute provides, in relevant part:

> (a)(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in

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[2] The patent at issue in this case defines pinch resisitant as "maintaining a clearance or gap of less than 9 millimeters at all times during door movement."

> commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or fase or misleading representation of fact, which—
>
> (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities
>
> Shall be liable in a civil action by any person who believes that he or she is or is likely to be damages by such act.

15 U.S.C. § 1125(a)(1) & (a)(1)(B) (1994).

The Sixth Circuit has set forth five elements that Wayne-Dalton must establish to prove a violation of this statute: (1) Amarr has made false or misleading statements of fact concerning its own product or another's; (2) the statement actually or tends to deceive a substantial portion of the intended audience; (3) the statement is material in that it will likely influence the deceived consumer's purchasing decisions; (4) the advertisements were introduced into interstate commerce; and (5) there is some causal link between the challenged statements and harm to Wayne-Dalton. *American Council of Certified Podiatric Physicians and Surgeons v. American Board of Podiatric Surgery, Inc.*, 185 F.3d

606, 613 (6th Cir. 1999) (hereinafter "Podiatric Physicians").

To meet the first element, Wayne-Dalton must show that Amarr's advertisement was either literally false or that it is true yet misleading. *Id.* at 614. If statements are literally false, a violation may be established without evidence that the statements actually misled customers. *Id.* In such circumstances, actual deception is presumed.[3] By contrast, "[w]here statements are literally true, yet deceptive, or too ambiguous to support a finding of literal falsity, a violation can only be established by proof of actual deception (i.e., evidence that individual customers perceived the advertisement in a way that misled them about the plaintiff's product)." *Id.* Proof of actual deception requires demonstrating that a significant portion of the consumer population was actually deceived by the

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[3] Subsequent to Podiatric Physicians, the Sixth Circuit explained, "While literal falsehood or the likelihood of deception may be sufficient to entitle [plaintiff] to injunctive relief or reimbursement for responsive advertising, it should not permit [plaintiff] to recover for injuries to goodwill in the absence of some more substantial indication that these injuries actually occurred." *Balance Dynamics Corp. v. Schmitt Industries*, 204 F.3d 683, 694 (6th Cir. 2000). The Court need not determine whether Wayne-Dalton provides this "more substantial indication," as the Court finds the statements incapable of literal falsity and Wayne-Dalton's claim thus fails even under the *Podiatric* standard upon which it relies.

ambiguous or true-but-misleading statements. *Id* at 616.[4]

Cognizant of this standard, both parties have moved for summary judgment on Wayne-Dalton's claim for damages. Wayne-Dalton does not dispute that it offers no evidence that individual customers were misled by Amarr's advertisements. Instead, it claims the ads were literally false, so it need not show actual deception. Amarr argues that the ads were not literally false, and further that Wayne-Dalton cannot meet the corresponding higher standard for "true but misleading" because it has failed to produce any consumer surveys or other evidence to show that a substantial portion of the intended audience was deceived.

The Court must first determine whether the statements at issue may be determined literally false by a factfinder. *Podiatric Physicians*, 185 F.3d at 615 n.2 ("[T]he initial determination concerning whether a statement is ambiguous is a matter of law, while the determination as to whether facts exist so as to justify the statement is a question of fact"). If the statements are ambiguous, they can be true but misleading, but cannot be literally false. *Id.* Accordingly, if the statements are determined to be ambiguous, Amarr is entitled to summary judgment because Wayne-Dalton has not offered any evidence of actual deception. The Court considers statements

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[4] A different standard is used to evaluate a claim for injunctive relief. In such circumstances, a plaintiff may satisfy the second element of the Sixth Circuit's test by "showing only that the defendant's representations about its product have a tendency to deceive consumers." Balance Dynamics, 204 F.3d at 690.

in light of the intended audience, garage door dealers and consumers. *Id.* at 616.

Wayne-Dalton argues, citing DASMA's website as evidence, that the industry considers "pinch-resistant" doors to mean those doors that comply with DASMA 116. (Doc. No. 134, Ex. C, Ex. 3). In response, Amarr contends that (1) "pinch resistant" does not carry such a meaning to garage door dealers and consumers (Declaration of Michael Miller, Doc. No. 32, ¶ 5; Declaration of Tony Price, Doc. No. 30, at ¶ 5), (2) that both Amarr and Wayne-Dalton used the term "pinch resistant" in advertising in years prior to the development of DASMA 116 so the phrase does not (and cannot) only equate to DASMA 116 compliance (Doc. No. 140, Ex. C, 99-102; Ex. P), and (3) that DASMA 116 is susceptible to multiple expert interpretations and, therefore, is ambiguous. (Doc. No. 140, Ex. H, 13-17.)

The Sixth Circuit's opinion in *Podiatric Physicians* provides guidance in this area. In *Podiatric Physicians*, the Court examined a number of statements similar to the type at issue in this case and determined they were either ambiguous or true but misleading, such that the plaintiff was required to introduce evidence of actual deception to recover damages. Specifically, the Court found the statement that the American Board of Podiatric Surgery "is the only professionally recognized certifying board for podiatric surgery being recognized by the [Council on Podiatric Medical Education]" was one incapable of being literally false, explaining that "professionally recognized" was susceptible to multiple interpretations, and, therefore, was ambiguous. *Podiatric Physicians*, 185 F.3d at 615.

The Sixth Circuit also found the statement "there has been a proliferation of 'self-designated' organizations purporting to have the authority to recognize and certify in podiatric surgery" to be ambiguous. *Id.* The court explained that the most reasonable interpretation of "self-designated" was "not approved by another body." *Id.* It then detailed how the statement was capable of multiple interpretations, as the plaintiff could have been approved by another body, depending on whether one viewed the corporation which had created and approved plaintiff as an entity separate from the plaintiff. *Id.* Accordingly, the court determined that the statement was ambiguous. *Id.*

The court further found the statement that the American Board of Podiatric Surgery is "the only approved certifying board for podiatric surgery" to be ambiguous or true but misleading, determining that it was unclear what it meant to be an "approved" board. *Podiatric Physicians*, 185 F.3d at 615.

Comparing the statements considered by the Sixth Circuit in *Podiatric Physicians* to the statements at issue herein, the rejects Wayne-Dalton's assertion that advertisements declaring garage doors "pinch resistant" unambiguously means compliance with DASMA 116. The uncontroverted evidence shows that most consumers and dealers know little of DASMA and its voluntary safety standards, and do not correlate "pinch resistant" with "DASMA 116 compliant." (Mullet Dep., Doc. No. 140, Ex. C, 109; Miller Aff., Doc. No. 32, ¶ 5, Price Aff., Doc. No. 30, ¶ 5.) Moreover, both Wayne-Dalton and Amarr advertised their doors as pinch resistant long before the establishment of DASMA 116, so it strains credulity to suggest, as Wayne-Dalton does, that the phrase "pinch resistant" suddenly gained its

unambiguous meaning upon the creation of DASMA 116 in 2000. In addition, the patent at issue in this case provides its own separate definition of "pinch resistant:" "maintaining a clearance or gap of less than 9 millimeters at all times during door movement," which differs from the one set forth by DASMA 116. (Doc. No. 142, Ex. 1, cl2, ln10-15.) Accordingly, the Court finds that describing doors as "pinch resistant," is ambiguous as a matter of law, and Wayne-Dalton must demonstrate actual deception to sustain a claim for damages under 15 U.S.C. § 1125.[5]

Even if the term "pinch resistant" clearly conveyed the meaning "DASMA 116 compliant," the phrase still would be too ambiguous to support a finding of literal falsity because the test itself is ambiguous. The parties use different reference planes in determining whether a probe can be inserted .25 inches before being "accepted" or "rejected." DASMA itself has determined that the test needs clarification and the association has proposed changes which are currently pending. Indeed, John Scates, Wayne-Dalton's own expert, helped spur this clarification

[5] Although Wayne-Dalton spends nearly all of its briefing focused on Amarr describing its doors as "pinch resistant," Wayne-Dalton does also cite other Amarr advertisements as false, including (1) that Amarr's doors are "inspired by the little things . . . little hands," (2) that "neither fingers nor weather gets in," and (3) picturing a child or children in the proximity to the door along with one or more of the phrases Wayne-Dalton attacks. (WayneDalton's motion for summary judgment on the issue of literal false advertising, Doc. 134, 8.) Similar to advertisements that the doors are "pinch resistant, these advertisements do not reference DASMA 116 and do not unambiguously state as a matter of law that the doors are DASMA 116 compliant. Therefore, a claim for damages based on these advertisements also requires proof of actual deception.

when he responded to DASMA's request for comments on DASMA 116's effectiveness by stating

> Section 6.2.2 of DASMA 116 testing guidelines needs further clarification to define what "rejects both [probes]" means. How far can a probe enter before it is no longer "rejected"? What reference planes are to be used to determine the depth of insertion? Is this a static measurement, done at a single (undefined) articulation of the door? Does "rejects" mean that it will be pushed out during door movement? Perhaps the entire section 6.2 is unnecessary and should be removed."

(Doc. No. 140, Ex. B.)

Wayne-Dalton submitted a subsequent affidavit from Mr. Scates claiming that when he advised DASMA of his concerns that he was contemplating "various joint configurations," including "PAC-MAN"-like construction and that the Amarr doors he tested for Wayne-Dalton were not the stimulus for his comments to DASMA. Whatever his stimulus, the comments illustrate the point which DASMA has recognized: its test is subject to multiple interpretations. Scates admitted as much in his deposition, when he stated, "It is unclear, also, with the pinch-resistant as to what the reference plane is." (Doc. No. 140, Ex. A., 62.)

Accordingly, because the term "pinch resistant" is ambiguous as a matter of law, Wayne-Dalton must present evidence that a significant portion of the consumer population perceived the

advertisements in a way that misled them about Amarr's doors to sustain its claim for damages. *Podiatric*, 185 F.3d at 614. It is undisputed that Wayne-Dalton has failed to present any such evidence. Thus, Amarr is entitled to summary judgment on Wayne-

Dalton's claim for damages.

ii. Laches

Even if Wayne-Dalton prevailed in proving literal falsity, its claim for damages accruing prior to the filing of this suit would still fail due to the equitable doctrine of laches.[6] Unlike statutes of limitations, laches does not contemplate a concrete matter of time. It is instead a question of the inequity of allowing the claim to be enforced. *Ford v. Catalanotte*, 342 F.3d 543, 550 (6th Cir. 2003). A party asserting laches must show: (1) lack of diligence by the party against whom the defense is asserted, and (2) prejudice to the party asserting it. *Nartron Corp. v. ST Microelectronics Inc.*, 305 F.3d 397, 408 (6th Cir. 2002). In the Sixth Circuit, a strong presumption exists that a plaintiff's delay in asserting its claims is reasonable as long as it has done so within the analogous statute of limitations. *Elvis Presley Enters., Inc. v. Elvisly Yours, Inc.*, 936 F.2d 889, 894 (6th Cir. 1991). An action is presumed barred, however, if not brought within the statute of limitations. *Tandy Corp. v. Malone & Hyde, Inc.*, 769 F.2d 362, 365 (6th Cir. 1985). Under Ohio law, as both parties concede, the statute of limitations analogous to Lanham Act claims is two years. *See*

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[6] As discussed infra, under Sixth Circuit law, laches does not apply to post-filing damages or injunctive relief.

Ameritech, Inc. v. Am. Info. Tech. Corp., 811 F.2d 960, 963 (6th Cir. 1987); Ohio Rev. Code § 2305.10. The period of delay begins to run when Wayne-Dalton had actual or constructive knowledge of the alleged infringing activity. *Nartron*, 305 F.3d. at 408.

In this case, Wayne-Dalton cannot show a genuine issue of material fact as to whether it lacked diligence in pursuing its rights or whether Amarr suffered prejudice. The record demonstrates that Amarr has been advertising its doors as "pinch-resistant" since 1999. From 2000 to the present, Wayne-Dalton has run its own advertisements in the same issues of the publications in which it claims Amarr made false advertisements. (Doc No. 50, Attach. 1, 2, 3.) Moreover, Wayne-Dalton personnel have testified that Wayne-Dalton commonly monitors its competitors advertisements and tests their products. (Doc. No. 42, Ex. C, ¶¶ 5, 6, 10.) Accordingly, Wayne-Dalton cannot claim that its alleged lack of actual knowledge prevents laches from acting as a bar to its claim.

Wayne-Dalton argues that it cannot be charged with constructive knowledge because, until December 2005, it had no knowledge of at least one of Amarr's doors, the Classica, which allegedly was falsely advertised. Wayne-Dalton's argument misapprehends the standard of constructive knowledge. Constructive knowledge is "imputed when one by exercise of reasonable care would have known a fact." *Comerica Bank v. Suburban Trust & Sav. Bank*, No. 95-1551, 1996 U.S. App. LEXIS 26778, *20 (6th Cir. Oct. 10, 1996). Wayne-Dalton, pursuant to testimony from its own witnesses, had constructive knowledge of Amarr's alleged false advertising long before July of 2004 -- two years

prior to the filing of this lawsuit. Regardless of whether another falsely advertised door entered the market, Wayne-Dalton would have known through the exercise of reasonable care that Amarr was advertising its doors as "pinch resistant" in alleged non-compliance with DASMA 116 prior to July of 2004. In addition, Wayne-Dalton has failed to put forth any evidence to dispute Amarr's evidence that the Classica was advertised in early 2004. Because the undisputed evidence shows that the Classica door was advertised in early 2004 in a manner similar to that which gave Wayne-Dalton constructive knowledge of Amarr's other doors, Wayne-Dalton had constructive knowledge of the false advertisement of the Classica door more than two years prior to the filing of this lawsuit.

Because the Court finds that Wayne-Dalton failed to bring its claim for allegedly false advertising within the analogous two year statute of limitations, the delay is presumed unreasonable and prejudicial, and the claim is presumed barred. *Tandy Corp. v. Malone & Hyde, Inc.*, 769 F.2d 362, 366 (6th Cir. 1985). This presumption can be overcome by (1) rebutting the presumption of prejudice; (2) establishing a good excuse for the delay; or (3) showing that Amarr engaged in "particularly egregious conduct which would change the equities significantly in plaintiff's favor." *Nartron Corp.*, 305 F.3d at 409. Wayne-Dalton has failed to overcome the presumption by any of these means.

Wayne-Dalton offers no evidence to overcome the presumption of prejudice, as Amarr's potential damages have increased during each year that the advertisement was used. *See Nartron Corp.*, 305 F.3d at 411 (any prejudice is sufficient, including an

increase in potential damages or a loss of evidence). Wayne-Dalton also failed to establish a good excuse for the delay. Wayne-Dalton claims that it tested Amarr's doors in 1999 and found that they passed the DASMA 116 test, so its delay in bringing suit was excusable.[7] This argument is belied by the testimony of multiple Wayne-Dalton executives that they consistently test competitor's doors and monitor competitor's advertisements. Wayne-Dalton has not provided evidence suggesting that Amarr made changes to the design of the doors so they only began to fail DASMA 116 within the statute of limitations period.[8] Instead, the record shows that Wayne-Dalton had constructive knowledge of the advertisements prior to July of 2004, and regularly checked competitors' doors for compliance.[9]

The record also fails to reveal any "egregious conduct" on the part of Amarr. There is no evidence that Amarr tricked Wayne-Dalton into resting on its rights. Instead, both Amarr and Wayne-Dalton have

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[7] At that time, DASMA 116 was merely a proposal and had not yet been adopted.

[8] Wayne-Dalton merely cites Amarr's advertisements to speculate that Amarr changed the design of its doors. (Doc. 58, 8.) The advertisement Wayne-Dalton cites bears a date of 2003. Thus, Wayne-Dalton had notice of this alleged change prior to July 21, 2004, the effective date of the applicable two year statute of limitations.

[9] Wayne-Dalton's claims that its delay is excused by the fact that Amarr's CEO served as President of DASMA from 2002 to 2004 is similarly unavailing. The position of Amarr's CEO is of little relevance to whether Wayne-Dalton had constructive knowledge of Amarr's false advertising. If anything, it only heightened the profile of Amarr's doors and encouraged Wayne-Dalton to continue to monitor Amarr's advertising.

advertised their doors as pinch resistant in the same publications for several years. Accordingly, Wayne-Dalton's claim for pre-filing damages fails for two independent reasons. In addition to failing due to a lack of evidence of actual deception, there is no genuine issue of material fact that Wayne-Dalton's claim for pre-filing damages is barred by the equitable doctrine of laches.

iii. Injunctive Relief

Wayne-Dalton argues that, even if laches applies to this case, it does not bar injunctive relief or for its claim for post-filing damages. The Court has already ruled that Wayne-Dalton's claim for damages is subject to summary judgment for lack of actual deception. The claim for injunctive relief, however, survives.[10]

Amarr's only argument in support of summary judgment on the claim for injunctive relief is that it is barred by the doctrine of laches. In a recent case, like this one, involving claims under 15 U.S.C. § 1125, the Sixth Circuit held that, "Laches only bars damages that occurred before the filing date of the lawsuit. It does not prevent plaintiff from obtaining injunctive relief or post-filing damages." *Nartron Corp. v. STMicroelectronics*, 305 F.3d 397, 412 (6th Cir. 2002) (citing *Kellogg Company v. Exxon Corp.*, 209 F.3d 562, 568 (6th Cir. 2000) (also a claim under the Lanham Act)). *See also Morel Acoustic, LTD. V. Morel Acoustics USA, Inc.*, No. 04-CV-348, 2005 U.S. Dist. LEXIS 32864, at *8 (S.D. Ohio Sept. 7, 2005)

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[10] Because the sole remaining claim sounds in equity, not in law, it will be tried to the bench. *See City of Monterey v. Del Monte Dunes*, 526 U.S. 687, 713 (1999).

("Laches does not bar injunctive relief and does not bar damages that occur after the filing of the suit."); *Freed v. Farag*, 994 F. Supp. 887, 891 (N.D. Ohio 1997) (proclaiming in the context of a claim of trademark infringement under the Lanham Act, "Prospective relief in an infringement action is not barred by a finding of laches."). As other courts have recognized, the primary basis for the distinction is that "[l]aches stems from prejudice to the defendant occasioned by the plaintiff's past delay, but almost by definition, the plaintiff's past dilatoriness is unrelated to a defendant's ongoing behavior that threatens future harm." *Jarrow Formulas, Inc. v. Nutrition Now, Inc.* 304
F.3d 829, 840 (9th Cir. 2002).

Amarr cites to cases from the Ninth, Seventh, and Second Circuits for the proposition that laches can bar damages and equitable relief. Amarr's argument is foreclosed, however, by controlling Sixth Circuit precedent.[11]

D. Patent Infringement

Both parties have also moved for summary judgment on the patent infringement claim, and Amarr has moved for a stay. The patent at issue,

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[11] Amarr has represented in a footnote to one of its briefs that it has now voluntarily removed references to "pinch resistantce" from its advertising pending the adoption of the revised and clarified DASMA standard. (Doc. 140, 8 n7.) Thus, it would appear that Wayne-Dalton's claim for an injunction enjoining Amarr from distributing advertising relating to compliance with DASMA 116 would be moot. Wayne-Dalton, however, also prays for an order instructing Amarr to recall its advertising relating to DASMA 116 and an order instructing Amarr to publish corrective advertising. These claims are, therefore, not moot and may proceed.

U.S. Patent No. 6,640,872 B1 ("the '872 Patent") is one for a sectional door, ordinarily a garage door. Under Claims 1 and 25 of the patent, such a door has center hinges offset from the side hinges in order to maintain a clearance between adjacent panels.

Claim 1 states:

> A sectional door movable between a closed vertical position and an open horizontal position comprising, a series of adjacent panels, each of said panels having an upper joint member and a lower joint member, said lower joint member having a configuration to establish a clearance with the configuration of the upper joint member of an adjacent panel during angular articulation of said adjacent panels in moving between the closed vertical position and the open horizontal position, end hinge assemblies located proximate the longitudinal ends of said panels and connecting said adjacent panels at a first pivot axis, and at least one center hinge assembly connecting said adjacent panels at a second pivot axis offset from said first pivot axis, whereby a portion of said clearance is maintained irrespective of variations in the deflection of said panels in moving between the closed vertical position and the open horizontal position.

As both parties and the Court have previously recognized, Claim 25 is not substantively different

from Claim 1. (Memorandum Opinion and Order ("Markman Opinion"), Doc. No. 109.)

Wayne-Dalton is the patent's assignee, but the parties dispute who invented the subject matter of '872 Patent first. Amarr has produced evidence that it developed the method of offsetting the center hinges by May of 2001, and prepared and disseminated a formal instructional memorandum advising those in the field how to offset the hinges to create sustained clearance during angular articulation. Wayne-Dalton originally answered interrogatories claiming that its earliest date of invention was August of 2001 and that the invention was first disclosed on September 24, 2001. (Doc. No. 133, Ex. C.) Wayne-Dalton has since claimed that it invented the subject matter of the '872 Patent in February, 2001. (Doc. No. 143, 57-58; Doc. No. 143, Ex. 10, Ex. 3.) It is undisputed, however, that the '872 patent was issued on November 4, 2003.

After the Court held a *Markman* hearing and issued its decision, Amarr petitioned the United States Patent Office ("PTO") for a reexamination of the patent's validity. In the interim, the parties filed their respective motions for summary judgment. The patent office has since granted Amarr's reexamination request and has communicated its initial position that the claims at issue in this case are invalid due to obviousness under 35 U.S.C. 103(a). (Doc. No. 149, Ex. B, 4, 22.) After learning of the PTO's decision, Amarr immediately filed its motion to stay this litigation with regard to the patent infringement claim pending the outcome of the PTO proceeding. (Doc. No. 149.) Wayne-Dalton opposes the stay. (Doc. No. 153.)

Reexamination of patent validity is brought under 35 U.S.C. § 301 *et seq*. A reexamination may be requested by any person upon showing the existence of prior art, "consisting of patents or printed publications which that person believes to have a bearing on the patentability of any claim of a particular patent." 35 U.S.C. §§ 301, 302. The PTO must then determine within three months "whether a substantial new question of patentability affecting any claim of the patent concerned is raised by the request, with or without consideration of other patents or printed publications." 35 U.S.C. § 303(a). Reexamination, if granted, may result in an order cancelling the patent as unpatentable, amending the patent, or confirming the patent's validity. 35 U.S.C. § 282; *Akzenta Paneele + Profile GmbH v. Unilin Flooring N.C., LLC*, 464 F.Supp.2d 481, 483 (D. Md. 2006). The reexamination statute was enacted "to correct errors made by the government, to remedy defective governmental [] action, and if need be to remove patents that should never have been granted." *Patlex Corp. v. Mossinghoff*, 758 F.2d 594, 604 (Fed. Cir. 1985).

As the Federal Circuit has explained, Congress' intent in establishing the reexamination procedure was to provide a relatively quick and inexpensive resolution which would "allow courts to refer patent validity questions to the expertise of the Patent Office" and "reinforce investor confidence in the certainty of patent rights by affording the PTO a broader opportunity to review doubtful patents." *Patlex Corp.*, 758 F.2d at 602. Reexamination proceedings "facilitate trial of [an] issue by providing the district court with the expert view of the PTO." *Gould v. Control Laser Corp.*, 705 F.2d 1340, 1342 (Fed. Cir. 1983). Because of the "clear congressional

intent to maximize efficiency and reduce cost in this regard; [] district courts often stay patent proceedings pending reexamination." *Hewlett-Packard Co. v. Acuson Corp.*, No. C-93-0808 MHP, 1993 U.S. Dist. LEXIS 6449, at *4 (N.D. Cal. May 5, 1993). *See also ASCII Corp. v. STD Ent. USA, Inc.*, 844 F. Supp. 1378, 1381 (N.D. Cal. 1994) ("[T]here is a liberal policy in favor of granting motions to stay proceedings pending the outcome of USPTO reexamination or reissuance proceedings.") This Court has "inherent power to manage [its] docket and stay proceedings, including the authority to order a stay pending conclusion of a PTO reexamination." *Ethicon, Inc. v. Quigg*, 849 F.2d 1422, 1426 (Fed. Cir. 1988.)

When deciding whether to issue a stay, Courts weigh multiple factors, including (1) whether a stay would unduly prejudice or present clear tactical disadvantage to the non-moving party; (2) whether a stay will simplify the issues in question and trial of the case; and (3) the stage of the litigation at which the stay is sought. *Lincoln Elec. Co. v. Miller Elec. Mfg. Co.*, No 1:06CV2981, 2007 U.S. Dist. LEXIS 66340, at *3-4 (N.D. Ohio Sept. 7, 2007). A stay is justified when the "outcome of the reexamination would be likely to assist the court in determining patent validity and, if the claims were canceled in the reexamination, would eliminate the need to try the infringement issue." *Slip Track Sys., Inc. v. Metal Lite*, 159 F.3d 1337, 1341 (Fed. Cir. 1998).

In this case, the factors weigh in favor of a stay. The PTO has already expressed its view, subject to Wayne-Dalton's attempt to rebut that view, that the claims at issue in this case are invalid. A stay in this litigation will clearly simplify the

issues in question. If the patent office affirms its rejection of the claims, there will be no need for a trial in this Court, as one cannot infringe an invalid patent. If the PTO proceeding results in an amendment of the claims, it could inform this Court's ruling on summary judgment as to infringement. Indeed, even if reexamination of the patent affirms its validity, Wayne-Dalton will incur a benefit, not "undue prejudice." As the Federal Circuit has noted, patentees benefit from the reexamination proceedings when the patent's validity is affirmed, as the jury may be instructed that the PTO has held the claims patentable, thereby raising the Defendant's burden of proving unpatentability at trial. *Patlex Corp.*, 758 F.2d at 603 ("It is clearly appropriate that the jury be instructed that because the PTO has now held the claims in suit patentable in light of the additional art discovered by [Defendant], its burden of proof of unpatentability has become more difficult to sustain – a fact likewise to be taken into account by the trial judge."). A stay will also prevent the parties from being forced to prepare for and participate in a lengthy and expensive jury trial while simultaneously contesting these same issues in the PTO. Judicial economy also weighs against conducting such a trial, which could be simplified or eliminated by the pending PTO proceeding. *See Tap Pharm. Prods. v. Atrix Labs., Inc.*, 2004 U.S. Dist. LEXIS 2684, at *2 (N.D. Ill. March 4, 2004) (citing the PTO's statistics on reexamination and explaining "There is a significant chance that the PTO will either invalidate this patent or drastically decrease its scope.").

Admittedly, the parties have completed discovery in this action, which normally might weigh

in favor of proceeding to trial. Both sides have expended valuable resources on this litigation. This Court has not yet ruled, however, on summary judgment motions that may or may not resolve the case. The Court may benefit from the PTO's expert analysis. *Gould*, 705 F.2d at 1342. *See also Softview Computer Prods. Corp. v. Haworth, Inc.*, 56 U.S.P.Q. 2d 1633, at *10 (S.D. N.Y. Aug. 9, 2000). In addition, this is not a case where a party has sought a stay after a trial was already held. *See Viskase Corp. v. Am. Nat'l Can Co.*, 261 F.3d 1316, 1327-28 (Fed. Cir. 2001). While some courts have denied a stay based on the end of discovery and the proximity of trial, others have granted one. Ultimately, the determination is within the Court's discretion based on a weighing of the benefits and costs of issuing a stay. *Compare Toro Co. v. L.R Nelson Corp.*, 223 U.S.P.Q. 636, (C.D. Ill. July 25, 1984) (denying motion to stay where case had been dismissed on summary judgment, remanded on appeal, and then second summary judgment motion dispositive of case was pending); with *TDATA Inc. v. Aircraft Technical Publishers*, No. 2:03cv264, 2008 U.S. Dist. LEXIS 298, at *11 (S.D Ohio Jan. 4, 2008) (granting stay despite arising at the end of discovery where the reexamination would streamline the issues for trial). *See also Middleton, Inc. v. Minnesota Mining and Mfg. Co.*, No. 4:03CV40493, 2004 U.S. Dist. LEXIS 16812, at (S.D. Iowa Aug. 24, 2004) (granting motion to stay despite the fact that litigation had been pending for eight years because the scope of the reexamination and the technical expertise of the PTO indicated that the litigation would be aided by the PTO proceeding).

In addition, while some courts also look to whether the petition for reexamination was made for

a dilatory purpose in assessing the propriety of a stay, the timing of Amarr's motion to stay in this case is not a result of such tactics. *See Grayling Indus., Inc. v. Hittler*, No. 1:89-cv-451-ODE, at *2-3 (N.D. Ga. March 25, 1991); *Middleton, Inc.*, 2004 U.S. Dist. LEXIS 16812, at *26. Wayne-Dalton originally answered interrogatories claiming a date of conception of September, 2001. Amarr thus believed that its evidence that its date of conception in May, 2001, would invalidate Wayne-Dalton's patent as prior to Wayne-Dalton's claimed date of invention. Amarr learned later in discovery, however, that, despite its contrary answer to interrogatories, Wayne-Dalton was claiming a date of conception of February 2001. In addition, Amarr received the benefit of this Court's *Markman* opinion, which clarified that the patent's claims covered a broader range of subject matter than that being advanced by Amarr.[12] This interpretation and the knowledge that Wayne-Dalton was now asserting a date of conception prior to Amarr's prompted Amarr to file its request for with the patent office on the ground that the patent was

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[12] In the *Markman* opinion, this Court rejected Amarr's position that the term "one center hinge assembly connecting said adjacent panels at a second pivot axis offset from said first pivot axis" meant that a door's center hinges were only offset vertically below the pivot axis of the end hinges. Instead, the Court gave the referenced language its ordinary and customary meaning.

invalid. Immediately after learning of the PTO's decision, Amarr filed its motion to stay.[13]

Wayne-Dalton argues it will be unduly prejudiced by Amarr continuing to sell doors which allegedly infringe Wayne-Dalton's patent. There is no evidence to suggest, however, that Amarr does not have the financial resources to pay a judgment against it, even if that judgment includes damages that continue to accrue while the PTO proceeding is pending. Any detriment Wayne-Dalton suffers from the competition Amarr provides by allegedly infringing the patent can be remedied by money damages. Potential prejudice also is minimized by the fact that Wayne-Dalton does not sell doors under the patent at issue.

Wayne-Dalton further claims that this case is simple enough that the Court and the jury will not be aided by the technical expertise of the PTO. This assertion is belied by the complicated three-dimensional graphical images and engineering expert evidence currently in the record. Ultimately, the PTO proceeding can "provide valuable analysis to the district court which it could consider in reaching its determination" on the merits of this case, and the Court concludes that a stay is warranted. *Ethicon*, 849 F.2d at 1428. The Court will

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[13] Wayne-Dalton attempts to argue that Amarr's position is undercut by the position Amarr's counsel took in an unrelated case with respect to the stay of a reexamination proceeding after the district court in the parallel litigation had already entered judgment. Aside from the fact that the facts of that case are readily distinguishable from this one (there the case had already gone to trial and judgment had been entered), Wayne-Dalton disregards the time-honored maxim that a lawyer advocates on behalf of a client, and the views he or she espouses do not necessarily represent his or her own

thus stay the patent infringement claim pending the outcome of the PTO proceeding, and deny the motions for summary judgment regarding the patent infringement claim without prejudice to refiling when the stay is lifted following the resolution of the PTO reexamination proceedings.

III. Conclusion

In light of the foregoing discussion, the Court rules on the respective

motions as follows:

(1) Amarr's Motion for Summary Judgment (Doc. No. 48) is **GRANTED, in part**, and **DENIED, in part** and Amarr's Motion for Summary Judgment on plaintiff Wayne-Dalton Corp.'s inability to recover damages for its false and misleading advertising claim (Doc No. 128) is **GRANTED**. Specifically, summary judgment is granted as to WayneDalton's claim for damages for false advertising. The claim for injunctive relief remains.

(2) Wayne-Dalton's motion for summary judgment on the issue of Amarr's liability for literal false advertising (Doc. No. 134) is **DENIED**.

(3) Amarr's motion for stay of Wayne-Dalton's patent claim (Doc. No. 149) is **GRANTED**.

(4) Amarr's Motion for summary judgment on Wayne-Dalton's Patent Claim (Doc.

No. 131) and 's Motion for Summary Judgment of Infringement (Doc. No. 126) are **DENIED WITHOUT PREJUDICE**. These two motions relating to the patent infringement claim may be refiled when the stay is lifted following the resolution of the PTO reexamination proceedings.

IT IS SO ORDERED.

Dated: January 23, 2008

/s/ Sara Lioi

UNITED STATES DISTRICT JUDGE

United States Court of Appeals
for the Federal Circuit

2008-1585

WAYNE-DALTON CORP.,

Plaintiff-Appellant,

v.

AMARR COMPANY,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Ohio in case no. 5:06-CV-01768, Judge Sara Lioi.

ORDER

NOTE: This disposition is nonprecedential.

United States Court of Appeals
for the Federal Circuit

ORDER

A combined petition for panel rehearing and for rehearing en banc having been filed by the Appellant, and the petition for rehearing, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on June 8, 2009.

FOR THE COURT,

Jan Horbaly
Clerk

MOTION FILED

OCT 12 2009

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(2)

No. 09-174

In The
Supreme Court of the United States

ANDREW D. GLOGOWER,

Petitioner,

v.

SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF AND BRIEF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF

The National Association of Insurance Commissioners ("NAIC") respectfully moves this Court, pursuant to Rule 37.2(b), for leave to file a brief as *amicus curiae* in this case in opposition to the Petition for a Writ of Certiorari, and in support of its motion states:

1. Counsel of record for the NAIC attempted to obtain the consent of all parties to the filing of an *amicus curiae* brief by the NAIC by contacting the parties' counsel of record.

2. The Respondent, Sharon P. Clark, has consented to the filing of an *amicus curiae* brief by the NAIC through counsel of record, Greg E. Mitchell Esq.

3. The Petitioner, Andrew D. Glogower, through counsel Kathi Mann Sandweiss, did not consent to the filing of an *amicus curiae* brief by the NAIC, although the Petitioner's Petition for a Writ of Certiorari makes numerous references to the *amicus curiae* brief filed by the NAIC during the Ninth Circuit's consideration of this case.

4. The NAIC has a strong interest in this case as set out fully in the brief submitted with this motion because the case concerns the interests of the states in regulating insurer insolvencies and enforcing resulting state court action.

5. The interest of the NAIC is implicated when federal bankruptcy proceedings are enmeshed with an insurer insolvency, which states are entitled to regulate under the McCarran-Ferguson Act of 1945, 15 U.S.C. § 1011, *et seq*.

6. As the representative of the coordinated and considered views of the state government officials that regulate and enforce the insurance laws of the country, the NAIC is uniquely qualified and situated to apprise this Court of the potential national impact if state insolvency courts are not granted due deference in related bankruptcy proceedings.

WHEREFORE, the National Association of Insurance Commissioners respectfully moves this Court for leave to file the following brief as *amicus curiae* in support of the Respondent.

Respectfully submitted,

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INTEREST OF *AMICUS CURIAE*[1]

1. IDENTITY OF *AMICUS CURIAE*

The National Association of Insurance Commissioners ("NAIC") is a not-for-profit Delaware corporation whose membership consists of the chief insurance regulatory officials of each state, the territories and insular possessions of the United States and the District of Columbia. Created in 1871, the NAIC is the nation's oldest association of state government officials. The mission of the NAIC is:

> [T]o assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost effective manner, consistent with the wishes of its members: promote the public interest; promote competitive markets; facilitate the fair and equitable treatment of insurance consumers; promote the reliability, solvency and financial solidity of insurance institutions; and support and improve state regulation of insurance. NAIC Mission Statement, http://www.naic.

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[1] No counsel for a party authorized this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission. Counsel of record for all parties received notice at least ten days prior to the due date of the *amicus curiae's* intention to file this brief.

org/index_about.htm (last visited October 6, 2009).

The NAIC's purpose is to provide its members with a national forum enabling them to work cooperatively on regulatory matters that transcend the boundaries of state jurisdictions. Collectively, the state insurance commissioners work to develop model legislation, rules, regulations, white papers and actuarial guidelines that promote and establish uniform regulation. Their overriding objectives are to protect consumers as well as assist in maintaining the financial stability of the insurance industry.

Any member of the NAIC may request the filing of an *amicus curiae* brief. All such requests require approval by the NAIC's Executive Committee. The Executive Committee has approved the filing of this *amicus* brief in opposition to the Petition for Writ of Certiorari.

2. INTEREST OF *AMICUS CURIAE*

The members of the NAIC have an interest in the continued strength of state-based regulation of insurer insolvencies. The Respondent, Sharon P. Clark, is the Commissioner of Insurance for the Kentucky Department of Insurance. The Petitioner's bankruptcy proceedings are enmeshed with the efforts of Commissioner Clark in regulating an insurer insolvency and going through the appropriate state court process to protect consumers. It is of great concern to the NAIC's members to see these efforts potentially

undone without due regard for state insurance regulation.

Each NAIC member promotes the objective of solvent insurance institutions. NAIC members act as the chief insurance regulator in each state and as the officer charged with handling insurer receiverships for the state. Individually and collectively, the NAIC's members and the state agencies over which they preside have a wealth of experience in the regulation of insurer insolvency. The NAIC's members understand the interests of insurance consumers and others affected by the consequences of an insurer insolvency, and work daily to protect those interests. The NAIC's members are uniquely qualified and situated to assist this Court by representing the regulatory and public policy concerns involved in this case.

Furthermore, this case implicates the primacy of the states in regulating insurance insolvency. The members of the NAIC are charged with the responsibility of regulating the business of insurance within their jurisdictions pursuant to the McCarran-Ferguson Act of 1945 ("the McCarran-Ferguson Act"), 15 U.S.C. § 1011, *et seq.*, and state insurance laws. The NAIC has extensive experience with the interpretation and application of the McCarran-Ferguson Act. The United States Supreme Court has stated that "[t]he views of the NAIC are particularly significant, because the Act ultimately passed was based in large part on the NAIC bill." *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221 (1979).

As this brief will discuss, the McCarran-Ferguson Act establishes that state regulation of insurance, including state insolvency proceedings, are not displaced by the federal bankruptcy laws. The two systems can operate side by side, as they did in this case to produce an appropriate outcome. The federal bankruptcy courts are responsible for applying federal bankruptcy law, and this can be achieved while giving due deference to factual issues determined in the course of state insolvency proceedings.

Finally, the Petitioner's Petition for Writ of Certiorari makes numerous references to the *amicus curiae* brief filed by the NAIC during the Ninth Circuit consideration of this case. Although the Petitioner has withheld consent for the NAIC to file an *amicus curiae* brief in opposition to his Petition, the NAIC certainly has an interest in clarifying the Petitioner's characterization of the NAIC's previous arguments.

The NAIC supports the Ninth Circuit's analysis, including consideration of the decision of the Franklin Circuit Court of the Commonwealth of Kentucky (Kentucky Circuit Court) regarding an important issue of fact; specifically, that the National Business Association Trust ("NBAT") and National Benefit Administrators ("NBA") constituted a single entity. This finding established an express trust as to both entities for purposes of determining fraud or defalcation while acting as a fiduciary under federal bankruptcy laws. The NAIC seeks to aid the United States Supreme Court by offering the legal position

and public policy perspectives of our association and NAIC member states.

SUMMARY OF ARGUMENT

The United States Court of Appeals for the Ninth Circuit was correct in holding that certain bonus and loan payments the Petitioner made to himself from NBA, the administrative arm of his self-funded insurance trust, were not dischargeable in bankruptcy. In making this determination, the Ninth Circuit gave full faith and credit to a Kentucky state court decision holding that NBA and NBAT constituted a single entity.

Due deference to the state court's factual finding is necessary in order to preserve state authority to regulate the business of insurance. The authority was expressly granted by the McCarran-Ferguson Act, which sets forth specific and limited conditions for any kind of preemption by federal law. United States Supreme Court precedent provides that insolvency falls within the "business of insurance" for purposes of state authority.

The Ninth Circuit's decision in this case effectively balanced the authority of the federal government over bankruptcy proceedings with the autonomy of the states to regulate the business of insurance, including insolvency regulation. Had the Ninth Circuit chosen to ignore the state court's factual findings, the rights of all states to regulate

insurer insolvency, and assign personal liability where appropriate, would have been badly compromised.

ARGUMENT

1. The states have clear authority to regulate the business of insurance.

The NAIC adopts the Statement of the Case as set forth by Respondent Sharon P. Clark, Liquidator of NBAT and NBA. The Petitioner was the chairman of the board and chief executive officer of NBA. *See Glogower v. Miller*, 2007 WL 1577880, *1 (D.Ariz. May 31, 2007). NBA was the administrator of NBAT, with authority to market NBAT coverage, to set and collect premiums, to adjust and settle claims, and to otherwise transact the business of NBAT. *See id.* NBAT provided self-funded health insurance coverage to employers in 21 states, including the Commonwealth of Kentucky. *See* Opening Brief for Appellant at 8, *Miller v. Glogower*, No. 07-16188, (9th Cir. Jan. 25, 2008). The NAIC joins Kentucky in its characterization of NBAT as a multiple employer welfare arrangement ("MEWA") subject to state regulation. *See id.* at 36. NBAT paid NBA twenty percent of all contributions to the trust as an administrative fee. *See id.* at 9. In 1988, the Petitioner approved a promissory note from NBA to himself for "accrued but unpaid salary." *See Glogower v. Miller*, 2007 WL 1577880, *1. NBA made loan payments on this

promissory note in the total amount of $395,000 from 1989 to 1990. *See id.* The Petitioner also approved a bonus payment of $362,282.70 from NBA to himself in 1989. *See id.*

The NAIC and its member states have extensive experience with MEWAs like NBAT/NBA. Under the Employee Retirement Income Security Act ("ERISA"), states have the primary responsibility to regulate the fiscal soundness of MEWAs and to license their operators. *See* 29 U.S.C. § 1001, *et seq.*; 29 U.S.C. § 1002(40); 29 U.S.C. § 1144(b)(6)(A). MEWAs generally are plans or other arrangements that provide health and welfare benefits to the employees of two or more employers, and as such resemble unlicensed group insurance carriers. The reasons for state regulation of MEWAs can be found in the report issued by the United States General Accounting Office ("GAO"), U.S. GEN. ACCOUNTING OFFICE, PRIVATE HEALTH INSURANCE: EMPLOYERS AND INDIVIDUALS ARE VULNERABLE TO UNAUTHORIZED OR BOGUS ENTITIES SELLING COVERAGE, 312 (2004). In this report, the GAO identified 144 entities not authorized to sell health benefits coverage from 2000 through 2002. These unauthorized entities covered at least 15,000 employers and more than 200,000 policyholders, and left at least $252 million in unpaid medical claims. Many of these entities took the form of self-funded employer health plans like NBAT/NBA, but were later determined to be unauthorized MEWAs subject to state solvency regulation.

On June 20, 1991, the Kentucky Circuit Court ruled that NBAT was an unauthorized insurer doing business in Kentucky. *See Glogower v. Miller*, 2007 WL 1577880, *1. In the same ruling, the Kentucky Circuit Court found that NBAT was insolvent and ordered its liquidation. *See id.* On May 10, 1995, the Kentucky Court ruled that NBAT acted through and as one with NBA. *See Wright v. National Business Association Trust*, No. 90-CI-01207, (Franklin Cir. Ct. Ky. May 10, 1995). The Kentucky Circuit Court reasoned that NBA had sole control of management of NBAT; that NBAT had no offices or operations other than those provided by NBA; and that NBAT had no employees or officers other than the Petitioner. *See id.* Since NBA was financially dependent on NBAT, the Kentucky Circuit Court held that NBA was also insolvent. *See id.* This analysis established that NBA and NBAT functioned as a "single entity."

The corporate structure of NBA and NBAT is an important issue because it controls the question of whether the Petitioner's transfers from NBA constituted fraud or defalcation under the Bankruptcy Code. *See* the Bankruptcy Act of 1978, 11 U.S.C. § 101, *et seq.*; 11 U.S.C. § 523(a)(4). The corporate structure is also determinative as to whether the Petitioner was a fiduciary under the ERISA. The Ninth Circuit recognized the fiduciary relationship arises from an express or technical trust. *See In re Glogower*, 320 Fed.Appx. 809, 811 (C.A.9 April 3, 2009). NBAT was an express trust and an ERISA

plan. If NBAT and NBA constituted a single entity, as the Kentucky Circuit Court and the Ninth Circuit have both held, then the loan payments and bonus payments constitute "fraud or defalcation while acting in a fiduciary capacity" under 11 U.S.C. § 523(a)(4) and are not dischargeable. *See id.* at 812.

This leaves the Petitioner with few avenues other than to make a broad assertion that the United States Bankruptcy Code necessarily excludes or displaces all state insolvency proceedings. However, the history of insurance regulation in the United States reveals a much more complex relationship between federal and state law. In this case, there is no specific state law conflicting with federal bankruptcy law. The NAIC disputes the Petitioner's "all or nothing" approach suggesting that only the Commonwealth of Kentucky or the federal government can prevail in this case. To the contrary, the Ninth Circuit's decision applied provisions of the bankruptcy code in light of facts established in the course of state insolvency proceedings, achieving a balance of debtor, regulator and consumer interests. To have ignored the Kentucky Circuit Court's factual conclusions would have flown in the face of 64 years of clear Congressional support for state-based insurance regulation.

A. The passage of the McCarran-Ferguson Act was a clear and deliberative action whereby Congress authorized the continuing regulation of the business of insurance by the states.

The McCarran-Ferguson Act was enacted in 1945 to subject the business of insurance to the laws of the several states. *See* 15 U.S.C. § 1012(a). The statute accomplishes this by "revers[ing] the doctrine of preemption in cases involving state insurance laws, such that a state law specifically regulating the business of insurance . . . preempt[s] a conflicting federal law unless that federal law specifically relates to the business of insurance." *Blackfeet National Bank v. Nelson*, 171 F.3d 1237, 1244 (11th Cir. 1999) (citing *U.S. Dept. of the Treasury v. Fabe*, 508 U.S. 491 (1993)). Under the McCarran-Ferguson Act, federal statutes enacted pursuant to Congressional Commerce Clause powers "cannot preempt state insurance laws unless the federal statute explicitly provided for such preemption." *Greene v. U.S.*, 440 F.3d 1304, 1311 (2006).

Courts have, over time, developed tests to determine whether state insurance laws survive this reverse preemption test.[2] The United States Supreme Court addressed this issue in *Humana v. Forsyth,* 525

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[2] *See Sabo v. Metropolitan Life Ins. Co.*, 137 F.3d 185 (3rd Cir. 1998), *cert. denied*, 525 U.S. 1129 (1999); *see Merchants Home Delivery Service, Inc. v. Frank B. Hall & Co. Inc.*, 50 F.3d 1486, 1489 (9th Cir. 1995), *cert. denied*, 516 U.S. 964 (1995).

U.S. 299 (1999). The Court determined that state law continued to govern where: (1) the state law was enacted "for the purpose of regulating the business of insurance;" (2) the federal law does not "specifically relat[e]s to the business of insurance;" and (3) the federal law would "invalidate, impair or supersede" state law. *Id.* at 307. Since *Humana*, courts have consistently applied this three-part analysis.

The NAIC is not presenting an argument that any specific state law takes precedence over federal bankruptcy laws in this case. The Petitioner is the only party arguing for preemption. However, it must be noted the Petitioner's assertion that "typical principles of res judicata and full faith and credit give way to the primacy of federal law" in the context of bankruptcy is completely refuted by the reverse preemption aspect of the McCarran-Ferguson Act. NBAT provided self-funded health insurance, subject to state insolvency proceedings that assigned personal liability to the Petitioner. The Petitioner's attempt to discharge that liability in bankruptcy brings the autonomy of the states in this area directly into consideration. As the reverse preemption mechanism in McCarran-Ferguson makes clear, it is not permissible to dismiss a state's interest in the regulation of insurance solely because a federal law comes into play.

In this case, it is neither permissible nor necessary to choose application of federal bankruptcy law to the detriment of state insolvency proceedings. There is no state law or regulation that presents a

conflict with bankruptcy law. There is only the analysis under 11 U.S.C. § 523(a)(4) – specifically, the determination of fraud or defalcation while acting in a fiduciary capacity. The analysis required certain factual findings that were readily at the disposal of the Ninth Circuit because the Commonwealth of Kentucky effectively managed the insurer insolvency. Again, these two systems functioned correctly and in tandem, resulting in the Ninth Circuit's ruling.

B. This primacy extends to insurer insolvency, which is a separate process from bankruptcy with its own consequences and findings of fact.

Another factor that supports the Ninth Circuit's deference to the Kentucky Circuit Court is the very nature of insolvency. It is well established that insurer liquidation and insolvency is an entirely separate process from bankruptcy. Federal bankruptcy laws provide that a person may not be a debtor under the bankruptcy code if such person is a domestic insurance company. *See* 11 U.S.C. § 109(b)(2). The U.S. Court of Appeals for the Fourth Circuit cited widely accepted reasoning for this provision:

> No reasons for making these exceptions were assigned by the committees of Congress, but they may be surmised to lie in the public or quasi public nature of the business, involving other interests than those of creditors, in the desirability of unarrested operation, *the completeness of state regulation, including*

> *provisions for insolvency*, and the inappropriateness of the bankruptcy machinery to their affairs.

In re Supreme Lodge of the Masons, 286 F. 180, 184 (D.C.Ga. 1923) (emphasis added).

The United States Supreme Court ruled that proper procedures and rules for liquidation of insurance companies are issues to which "the Supreme Court of [each] state will speak with ultimate authority". *Clark v. Williard*, 292 U.S. 112, 123 (1934). The *Fabe* case further clarified the autonomy of states to regulate insurer insolvencies following adoption of the McCarran-Ferguson Act. *See Fabe*, 508 U.S. at 508. In this preemption case, the United States Supreme Court established that state insolvency laws related to the business of insurance to the extent such laws protect policyholders, rejecting prior arguments that insolvency laws did not relate to the "business of insurance" because the insurer is no longer conducting business following insolvency. *See id.*

Other advantages to placing the liquidation of insurance companies squarely within the purview of the state insurance regulators include judicial economy, ease of administration, and the states' interest in protecting the public. *See Sims v. Fidelity*, 129 F.2d 442, 448-9 (4th Cir. 1942). When the rights of policyholders are at stake, deference must be paid to the expertise of state insurance departments in liquidation proceedings and issues of insolvency.

State proceedings are ideal to manage insurer insolvency because they are flexible and responsive to different situations. To address the issues of a troubled company, a state can use pre-receivership tools such as administrative supervision or seizure, or it can proceed with conservation, rehabilitation or liquidation. *See* NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, RECEIVERS HANDBOOK FOR INSURANCE COMPANY INSOLVENCIES, 1-36 (2009). If a state court rules that liquidation is appropriate, the ensuing order will cancel the policies at hand, stay actions pending against the insolvent insurer, and require that all creditors be provided with a proof of claim form. *See* Davis J. Howard, *How to Fail at Liquidating an Insurance Company Without Really Trying; Appoint a Policyholders' Committee*, 39 FED'N OF INS. & CORP. COUNS. Q. 31, 34 (1988). This process is entirely separate from bankruptcy, to the point where "the very concept of analogizing any type of insurance company delinquency proceeding to a bankruptcy proceeding is inappropriate." *Id.* at 56.

Clearly, state insurance regulators are best equipped to handle insurer insolvencies. The insolvency of NBA/NBAT is entwined with the Petitioner's bankruptcy proceedings. The question of dischargeability for the bonus and loan payments cannot be determined in a vacuum. The state insolvency proceedings were soundly within the purview of the Kentucky Circuit Court, and the resulting factual findings were properly incorporated into the Ninth Circuit's analysis.

2. The Ninth Circuit acted appropriately in giving full faith and credit to the Kentucky Circuit Court ruling, which included an important factual determination of the "single entity" nature of NBAT and NBA.

As this case has progressed, the NAIC has supported the Respondent's position that deference must be paid to the factual findings of the Kentucky Circuit Court during insolvency proceedings for NBAT. The personal liability assigned to an individual in the course of insolvency proceedings is relevant to that individual's bankruptcy disposition. The Petitioner argues that deference to the Kentucky Circuit Court ruling is inappropriate because the Kentucky Circuit Court did not consider § 523(a)(4) and because its ruling did not apply the "single entity" issue to any bankruptcy laws. This is faulty reasoning. The Kentucky Circuit Court's role was to examine the corporate structure of NBA/NBAT for purposes of insolvency. The Ninth Circuit's role was to interpret § 523(a)(4) for purposes of the bankruptcy. Each court achieved its purpose, and there is no reason why one ruling has to be dismissed in favor of the other.

The Ninth Circuit's ruling upheld the Bankruptcy Court's determination that the Petitioner was an ERISA fiduciary, and therefore a fiduciary for purposes of § 523(a)(4). *See Glogower*, 320 Fed.Appx. at 811. The Petitioner's own admission that NBAT was an ERISA plan was part of this analysis. *See id.* The Ninth Circuit concluded that Petitioner's total

control over NBA, the administrative account, adhered to ERISA's provision that a fiduciary exercises discretionary authority or discretionary control respecting management of the plan. *See id.* at 812. The Court invoked the Kentucky Circuit Court decision as to one factual issue; specifically, that NBAT and NBA were one and the same entity. *See id.* It is disingenuous for the Petitioner to assert that this deference on a fact issue "exalts Kentucky state insurance regulations over federal bankruptcy law."

It is the function of the bankruptcy courts to determine dischargeability using all the facts at their disposal. The fact that NBA/NBAT constituted a single entity established that the Petitioner was a fiduciary with respect to bonus and loan payments. The finding extended the Petitioner's clear fiduciary status from NBAT to NBA. It was entirely appropriate for the Ninth Circuit to look to the Kentucky Circuit Court for guidance on this issue; quite simply, it was the only fact finder in the case's history that took up the question.

If the Ninth Circuit had failed to give full faith and credit to the Kentucky Circuit Court's determination, it would have nullified the painstaking efforts NAIC members have taken to regulate unauthorized insurers and to craft a uniform regulatory system of insolvency and liquidation. The Court's deference to the Kentucky Circuit Court's ruling

allowed state insolvency proceedings the recognition that is due under the McCarran-Ferguson Act.

CONCLUSION

For the foregoing reasons, this Court should deny the Petition for Writ of Certiorari.

Respectfully submitted,

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